Supreme Court of the United States

OCTOBER TERM, 1925

No. 37.

JOHN W. McCARDLE, MAURICE DOUGLASS, OSCAR RATTS, FRANK WAMPLER, and SAMUEL ABTMAN, as Members of the PUBLIC SERVICE COMMISSION OF INDIANA,

Appellants (Defendants below),

and

CITY OF INDIANAPOLIS,

Intervening Appellant (Intervenor and Defendant below)

vs.

INDIANAPOLIS WATER COMPANY,

Appellee (Plaintiff below).

BRIEF AND ARGUMENT FOR APPELLEE.

ALBERT BAKER,
JOSEPH J. DANIELS,
W. A. McINERNEY,
WILLIAM L. RAWSON,

Solicitors for Indianapolis Water Company.

SUBJECTS

SUBJECT INDEX

INDEX-DIGEST

INDEX TO APPENDIX

TABLE OF CASES

TABLE OF STATUTES

Supreme Court of the United States

OCTOBER TERM, 1925

JOHN W. MCCARDLE, MAURICE DOUGLASS, OSCAR RATTS, FRANK WAMPLER, and SAMUEL ARTMAN, as Members of the PUBLIC SERVICE COMMISSION OF INDIANA, *Appellants,* and CITY OF INDIANAPOLIS, *Intervening Appellant,* vs. INDIANAPOLIS WATER COMPANY, *Appellee.*	No. 245

BRIEF FOR APPELLEE

This case is here on appeal by the intervenor (the City of Indianapolis) and by the Public Service Commission of the State of Indiana (the defendants below), from a final decree (R. 56) of the United States District Court for the District of Indiana, in favor of the Indianapolis Water Company (the plaintiff below), entered on October 3, 1924, by Geiger, *D.J.*, after he had heard the testimony.

Statement

The action was brought by the Indianapolis Water Company (the present appellee) against the defendant members of the Public Service Commission of Indiana, to enjoin the enforcement of a schedule of water rates prescribed by the Commission, by an order dated November 28, 1923, in its Case No. 7080; such schedule having been prescribed by the Commission to take the place of rates promulgated by the company (R. 1-5).

The decree appealed from (R. 56) determined and adjudged that the Commission's schedule of rates were clearly confiscatory of the appellee's property (R. 56).

The decision of the District Court: In forming his independent judgment as to the consequences of the rates complained of, Judge Geiger found and determined that the value of the appellee's property, during the period litigated before the Commission and as of January 1, 1924, "was and is not less than $19,000,000" (R. 56).

The appellee had indicated $19,000,000 ($18,650,000 plus net additions) as a *minimum* figure for present value, *on incontestible bases,* although the complaint had also alleged (R. 5) that if wages and prices during the year 1923

> "should be applied in determining the fair value of its property owned throughout that year, and used and useful in its public service business, the fair value of such property was and is in excess of $22,000,000, as was established by the evidence before the Commission" (R. 5).

The District Court found and stated, in its decree (R. 56), that this and other "material averments of the complainant's bill of complaint" had been proved and sustained (R. 56). In fact, the Court found that the com-

pany's proofs of present replacement value showed approximately $25,000,000 (after deducting depreciation), and indicated that on no theory could this figure be reduced below $23,000,000 for the physical property only (R. 63), exclusive of going value, working capital, and water rights, for each of which elements of property the law of Indiana and the decisions of the appellant Commission require that an allowance shall be made, at present value. The chief engineer of the Commission estimated the 1923-1924 replacement value of the *physical property only* (less depreciation but exclusive of going value, working capital other than materials and supplies, and water rights) at $19,500,000 (R. 132).

Judge Geiger accordingly said that (R. 64):

> "I am not confronted with the problem of fixing a valuation within the range of dispute upon spot reproduction. I say I am not confronted with that problem, because the complainant comes into this Court and offers to accept $19,000,000 as a fair basis of valuation, even though, as it says, and I think has reason to say, and could support it, it could, upon the record, sustain a higher valuation" (R. 64).

He added that on any rational basis of valuation and return, "*provided it be above five per cent.,*" the rates are clearly confiscatory, saying (R. 64):

> "It follows, I think without dispute—I think without the possibility of serious dispute—that, that being so, the rates or tariffs or charges that have been promulgated by the respondent Commission, *no matter what figure of measuring it, what rate of measuring it, we adopt, providing it be above five per cent.,* that schedule will not satisfy the constitutional requirements of the plaintiff in this case" (R. 64).

Fundamental fallacy of the appellants' brief.

The brief of the appellants in this Court is based fundamentally on the unfounded assumption that the District Court "accepted a spot reproduction of January 1, 1924 (the time of the inquiry), as the *exclusive* measure of fair value" (Brief, page 48). At other points in their brief, the "straw man" set up and attacked by the appellants is that Judge Geiger accepted "spot reproduction cost" as the "dominant and *exclusive* measure of value" (See pages 50, 40, 37).

Although Judge Geiger discussed and analyzed recent decisions of this and other Courts, as indicating that substantial, and perhaps dominant, weight should be given to costs, wages and conditions at the time of the inquiry (R. 59-64), nevertheless, when he came to make his determination of value for the purposes of the case, he found that, as above quoted and hereinafter shown in detail, he "was not confronted with the problem of fixing a valuation within the range of dispute upon spot reproduction" (R. 64).

The inadequate sum on which the Commission proposed to allow a seven percent. return.

The appellant Commission had formulated its rate schedule to yield a return upon $15,260,400 (R. 32), and had ruled that *seven* per cent. was the "reasonable rate of return" (R. 31) upon such value. The Commission frankly stated its realization, however, that

> "the schedule of rates herein authorized may, for the immediate future, produce a rate of return *below seven per cent.*" (R. 31);

but expressed the belief that this condition might be relieved by "the continued rapid growth" of the company's business.

The District Court found that if, in fixing a valuation of $15,260,400, the Commission had "considered" "construction costs, conditions, wages and prices affecting value" as of 1923 and 1924, *"its consideration has led it to ignore it"* (R. 62).

The past practices and the present opinion of the Commission (R. 23-25) were deemed by Judge Geiger (R. 62) to contain considerable evidence that the figure of $15,260,400 had actually been reached by applying, to its inventory, prices averaged over a ten-year period, and then deducting "accrued depreciation" and whatever further sum the Commission thought necessary, in order to bring the value down to the desired figure. The *lowest* estimate, however, that was presented by any witness in the District Court, *on the basis of prices and wages averaged over a ten-year period which included the year 1923,* was that of the Commission's own chief engineer (Mr. Carter), and on this basis his figure (depreciated) was in excess of $17,000,000 (R. 132), *exclusive* of going value, water rights, and cash working capital. So even as to replacement costs based on prices and wages averaged over a ten-year period which included the time of inquiry, the District Court was bound to and did conclude that the Commission could not have reached the minimum figure of $15,260,400

> "except conjecturally, as I see it, in one of two ways: *either* the Commission cut down, *beyond any limit that was possible upon the evidence,* the valuation as indicated upon a ten-year price level, *or it substantially ignored every other element of value,* such as going-concern value" (R. 63).

The way in which the Commission's figure was evidently reached, in such a manner as virtually to exclude the possibility that any weight was given to unit prices and wages in 1922, 1923, or 1924, is described and discussed on pages 96 to 99 and 111 to 113, *post.* The unit prices used by the Commission were evidently obtained from averages *which excluded those years and gave dominant weight to pre-war costs.*

Evidently because the rate schedule complained of seemed so clearly confiscatory, Judge Geiger did not prepare a written opinion, and his oral opinion in this case (R. 56-64) has not been officially reported. In *Ashland Water Co.* v. *Railroad Commission of Wisconsin* (7 Fed. [2nd] 924; 25 Rate Research, 275), decided by the Special Statutory Court, his views as to the valuation of the property of a water company were set out with some care. They are quoted on pages 69 and 70, *post,* and give no support to the claim that he holds that "spot" reproduction cost should be given exclusive weight, in ascertaining present value.

The Commission's January and November valuations of the appellee's property in 1923.

On January 2, 1923, the Indiana Commission *(Re Indianapolis Water Co.,* P. U. R. 1923D, page 449), after "six months of hard and painstaking work" by its staff (R. 240) and after hearing evidence presented by the company and by the City of Indianapolis, fixed the value of the property of the present appellee at $16,455,000, made up as follows:

Tangible property (fixed capital)	$14,904,000
Going value and water rights	1,416,000
Working capital	135,000
Total fixed by order of January 2, 1923, in Case No. 6613	$16,455,000

The valuation thus fixed by the Commission, on January 2, 1923, was $5,727,193 below the reproduction cost (less depreciation) figure presented in that case in behalf of the company (R. 224, 225), this total of $22,182,193 having been based on construction costs, wages and prices affecting value as of October 1, 1922. Concerning its valuation of $16,455,000 in January of 1923, the Commission said (R. 239):

"There is no doubt that the element of *original cost* has been recognized *sufficiently*. There is *doubt* as to whether the element of reproduction cost new today has been given sufficient weight" (Italics ours).

Eleven months later, on November 28, 1923 *(Re Indianapolis Water Co.,* P. U. R. 1924B, page 306), the Commission fixed the value of the company's property at $15,260,400 (R. 32), made up as follows:

Tangible property (fixed capital)	$14,280,400
Going value, working capital and water rights (R. 22)	980,000
Total fixed by order of November 28, 1923, in Case No. 7080 (R. 32)	$15,260,400

From January to November, in 1923, the Commission itself admitted, "the general trend of commodity and labor prices has been slightly upward" (R. 25). The Commission's valuation of all the property by order of November 28, 1923, was *$4,371,883* less than the reproduction value (less depreciation) proved before it as of May 1, 1923, for the *physical property alone,* exclusive of going value, water rights, and cash working capital (R. 25). Not only this, but the Commission's valuation by order of November 28, 1923, was actually $1,194,600 less than its valuation by order of January 2, 1923, although additions and betterments had been made since October 31, 1922 (the valuation date under the January order). Giving no effect to net additions or to immediately projected expenditures (R. 4-5), the tangible property was taken at $623,600 less, and the going value, working capital and water rights were merged into a sum $571,000 less, *in November as compared with January.*

On the basis of this valuation, so sharply diminished *without explanation,* the Commission fixed the rates which

were duly adjudged confiscatory by the District Court, on the basis of Judge Geiger's independent judgment that the property was worth at least $19,000,000 on any rational theory of valuation and that the rates would not yield more than five per cent. thereon.

Summary of the issues of fact

For possible convenience, we present preliminarily a "birdseye view" of the issues to be discussed in detail:

As to value:

Judge Geiger's finding of a reproduction value (less depreciation) of $23,000,000 to $25,000,000 at 1923-24 "spot" prices, and his determination that the present value "was and is not less than $19,000,000" for the purposes of this case, may be compared with the following, which comprise all of the estimates before the Court which had been based on unit prices which gave any weight whatever to costs in 1923 or 1924:

Mr. Hagenah's estimate of reproduction value (less depreciation) at wages and prices as of January 1, 1924 (R. 180; fol. 218)..... $25,404,026.

Mr. Elmes' (Sanderson and Porter's) estimate of reproduction value (less depreciation) at wages and prices as of January 1, 1924 (R. 194) ..... 25,357,907.

Mr. Carter's estimate, as chief Engineer for the appellant Commission, of the reproduction value (less depreciation) at wages and prices as of January 1, 1924 (R. 132) (adding going value, cash working capital and water rights at only the Commission's allowance in Case No. 6613)..... 21,051,000.[1]

Average 1923-24 reproduction value (less depreciation) (obtained by averaging the

[1] This figure, as shown on page 30, *post*, included the land at substantially less than the undisputed testimony as to its market value.

only three estimates presented to the District Court) ..... $23,937,644.

Mr. Hagenah's estimate of reproduction value (less depreciation) at wages and prices averaged for *three-year* period ended December 31, 1923 (R. 180; fol. 218)..... 24,360,358.

Mr. Elmes' estimate of reproduction value (less depreciation) at wages and prices averaged for *three-year* period ended December 31, 1923 (R. 194)..... 23,927,372.

Average of above *uncontradicted* estimates of reproduction value (less depreciation) at wages and prices averaged for *three-year* period ended December 31, 1923..... 24,143,865.

Mr. Hagenah's estimate of reproduction value (less depreciation) at wages and prices averaged for *five-year period* ended December 31, 1923 (R. 180; fol. 218)..... 25,387,799.

Mr. Elmes' estimate of reproduction value (less depreciation) at wages and prices averaged for *five-year* period ended December 31, 1923 (R. 194)..... 24,823,103.

Average of above *uncontradicted* estimates of reproduction value (less depreciation) at wages and prices averaged for *five-year* period ended December 31, 1923..... 25,105,451.

Mr. Hagenah's estimate of reproduction value (less depreciation) at wages and prices averaged for *ten-year* period ended December 31, 1923 (R. 180; fol. 218)..... 22,359,354.

Mr. Elmes' estimate of reproduction value (less depreciation) at wages and prices

averaged for *ten-year* period ended December 31, 1923 (R. 194)	$21,891,224.
Mr. Carter's estimate, as chief engineer of the appellant Commission, of the reproduction value (less depreciation) at wages and prices averaged for *ten-year* period ended December 31, 1923 (R. 132) (adding going value, cash working capital and water rights at only the Commission's allowance in Case No. 6613)	18,557,370.[1]
Average of above estimates of reproduction value (less depreciation) at wages and prices averaged for *ten-year* period ended December 31, 1923	20,935,983.
Average of all of the above estimates of the reproduction value (less depreciation) of the appellee's property, at the various price levels indicated (the above being *all* of the estimates presented which gave any weight or effect to the unit prices, wages or construction costs prevailing at any time during 1922, 1923, or 1924)	23,311,951.

The *physical property only (less depreciation)* was estimated by Mr. Hagenah at $22,669,026 (R. 180; fol. 218), and by Mr. Elmes at $22,526,601 ($23,202.951 less $233,306 for cash working capital and also less $443,044 as Mr. Elmes' estimated cost of restoration) (R. 194). Adding for working capital, going value, and water rights *the lowest estimates supported by the uncontradicted opinion testimony* of any witness (viz., $2,000,000 for going value, $500,000 for water rights, and $235,000 for working capital), the estimates of 1923-24 replacement value (depreciated) become $25,404,026 and $25,261,601. Adding instead for these

---

[1] As shown on page 29, *post*, Mr. Carter's ten-year average did not include or give effect to the "peak" prices prevailing in 1917 or 1920 (R. 132).

three items the appellant Commission's inadequate January (1923) figure of $1,551,000 (R. 219), these appraisals become $24,220,026 and $24,077,601, respectively.

The Commission's own chief engineer (Mr. Carter) valued the *physical property only* (less depreciation), at 1923 prices, at $19,500,000 (R. 132). If we add to this the Commission's own January allowance for going value, working capital and water rights, Mr. Carter's valuation becomes $21,051,000, as the lowest estimate before the Court as to the 1923 value of the appellee's property (depreciated). If instead we add for these three elements the lowest figures supported by opinion testimony, the $19,500,000 figure for the physical property becomes $22,235,000 for *all* the property, *after* deducting Mr. Carter's estimate of depreciation, consisting of both the actual physical deterioration and his estimate of depreciation for age (R. 130).

Even on the lowest basis possible that would give any weight whatever to 1922, 1923 or 1924 wages, prices and costs (viz., using Mr. Carter's ten-year average prices ending December 31, 1923, and deducting his estimate of depreciation), Mr. Carter's value was $17,006,370 for the physical property (R. 132), and $18,557,370 if going value, working capital and water rights are added at even the Commission's own meager figure for these elements, in January of 1923. If to Mr. Carter's figure for the physical property only, at ten-year averaged wages and prices, there were added for going value, working capital and water rights the lowest estimates supported by the opinion testimony, Mr. Carter's figure would become approximately $19,741,370.

As to rate of return:

The Commission ruled that *seven* per cent. was sufficient (R. 31), and then proceeded to fix rates which it ad-

mitted would yield *less than seven per cent.* "for the immediate future" (R. 31), figured upon its meager "rate base."

The proofs, as reviewed on pages 117 to 123, *post,* showed the reasonable need for a return of *eight* per cent. upon present value.

As to earnings:

The difference between the parties as to 1924 *operating expenses* was $95,791.27. Mr. Metcalf, the consulting engineer for the company, estimated operating costs for 1924 (based closely upon actual costs to the time of trial in 1924) at $1,198,000 (Exhibit No. 23; R. 248; fol. 301). Mr. Perk's estimate for the City (Exhibit No. 59; R. 333-334) was $1,102,208.73.

The difference between the parties as to the 1924 *gross revenues* was $67,758.92. As to the income, Mr. Perk *assumed,* without warrant in the record or outside it, an increase of $357,256.56 (R. 333) in the appellee's gross revenues. His estimate for 1924 (Exhibit No. 59; R. 333) was therefore $2,223,758.92. The reliable estimate of Mr. Metcalf (Exhibit No. 26; R. 254), from his long familiarity with the company's business, was $2,156,000 ($2,127,000 plus $29,000 of non-operating revenue; R. 254). Mr. Jirgal's analysis of the company's accounts sustained Mr. Metcalf's figure (Exhibit No. 17; R. 245).

The net difference between the parties as to *net earnings* for 1924 was $163,550. Mr. Metcalf's estimate of *net earnings* for 1924 was $958,000 (Exhibit No. 26; R. 254). By assuming too great an increase in the company's revenues and by omitting various items of operating expenses, Mr. Perk estimated the 1924 net earnings at $1,121,550 (Exhibit No. 59; R. 334-335).

Mr. Perk's estimate of 1924 operating expenses did not include (1) the $25,000 of annual provision, or any provision, for the expense of Commission and Court hearings; or (2) the $17,800 of tax amortization, authorized by the Commission's own order. Mr. Perk also cut the annual provision for depreciation (retirement expense) from $135,000, the amount apparently sanctioned by the Commission (R. 31) and by its accountant (Mr. Boggs; R. 308), to $107,619.41—a decrease of $27,380.59. The remaining difference represents decreased allowance for 1924 taxes.

The few items in controversy as to operating expenses and revenues are discussed on pages 123 to 129, *post*.

Net return which would be allowed under the Commission's rates.

A return of eight per cent. upon the minimum valuation of $19,000,000 found by the District Court would amount to $1,520,000. To net the appellee this amount, by providing for the *additional* Federal income tax at 12½ per cent. on that amount of annual return (only $77,538 having been included for Federal income tax in Mr. Metcalf's 1924 Exhibit), the appellee's net earnings would have to amount to approximately $1,576,747., over and above all operating expenses and taxes.

As estimated by Mr. Metcalf at $958,000 (R. 254), the appellee's net earnings for 1924 would fail by $618,747, or to the extent of approximately 39 per cent., to yield the appellee an eight per cent. return.

Even as miscalculated by Mr. Perk, for the City, at $1,121,550 (R. 334-335), the appellee's net earnings for 1924 would fail by $455,197, or to the extent of nearly 30 per cent., to yield the appellee an eight per cent. return.

On the minimum valuation found by the District Court,

the net earnings for 1924, as shown by the company's witnesses (almost exactly the actual), would amount to no more than 5.04 per cent. (R. 254). Those net earnings would amount to an eight per cent. return upon no more than $12,000,000 of property, or a seven per cent. return upon no more than $13,690,000, which is $1,570,400 less than the Commission's "valuation."

The exhibit and calculations of the Commission's accountant showed exactly the same gross income figures as were presented by the company (R. 146); but even by swelling absurdly the gross revenues, as imagined by Mr. Perk for the City, and by cutting from operating expenses various sums *allowed by the Commission itself,* the appellants' brief cannot figure net earnings in excess of $1,121,550, which would amount to a return of no more than 5.9 per cent. on the minimum value fixed by the District Court.

Upon a sum in any way representative of the full value of the appellee's property as indicated by the District Court (say $23,000,000), the rates complained of would not yield more than 4.2 per cent.

The Commission's January determination as to the appellee and its well-maintained and efficient properties.

The Commission, in its opinion and order in Case No. 6613, found and stated *inter alia:*

> (i) The appraisals submitted by the Commission's staff "represented six months of hard and painstaking work" (R. 240);
>
> (ii) The engineering firms employed by the Company "are each of national reputation and unquestioned standing" (R. 240);

(iii) The whole plant "has been planned and constructed with an *ingenuity and economy and foresight* for the future needs of the city *that is unequalled* under any similar circumstances anywhere in the country" (R. 237);

(iv) Indianapolis is probably the "*most unfortunately situated of any large city* so far as the natural available water is concerned, yet the possibilities of an insignificant stream flowing through a thickly populated country-side have been *so thoroughly developed* that Indianapolis now has, and if it doubles in population will have, *an ample supply* of potent (potable) water *at a cost much below the cost in many other cities more favorably located*" (R. 237);

(v) This "development of its water rights, which has been accomplished by the Water Company, at times with extreme difficulty, *does actually largely increase the value of the property*" (R. 237);

(vi) "It is a matter of common knowledge that the Indianapolis Water Company is one of the best public utilities in the United States. *Its operating efficiency and maintenance is practically 100 per cent.* —its capacity is amply sufficient for the needs of the city—it has 53,000 consumers and 475 miles of mains. There are practically no complaints from private consumers or from the City as to the purity of the water, its sufficiency or pressure" (R. 239).

Standing of the appellants

Although the City of Indianapolis has no power or duty as to the fixation of the appellee's rates (*Re Englehard and Sons Co.*, 231 U. S. 646) and no relief is in any way sought against the municipality, the latter injected itself *as an intervenor* (R. 36-41) into this action, to which it was not a necessary party, and hardly a proper party.

City of New York v. *New York Telephone Co.*, 261 U. S. 312;
Consolidated Gas Co. of New York v. *Newton*, 256 Fed. 238; affd. 260 Fed. 1022; remanded for dismissal, 253 U. S. 219;
City of Mt. Vernon v. *New York Interurban Water Co.*, 115 App. Div. (N. Y.) 658;
Hoyne v. *Chicago Electric Ry. Co.*, 294 Ill. 413;
Morrell v. *Brooklyn Borough Gas Co.*, 231 N. Y. 405;
City of New York v. *New York Edison Co.*, 196 App. Div. (N. Y.) 644;
Federal Equity Rule No. 37.

The City of Indianapolis has participated actively in the various proceedings before the Indiana Public Service Commission, including both the hearings which led to the Commission's valuation order of January 2, 1923, and the hearings which eventuated in the rates here complained of (R. 13). The municipality presented what it moderately describes as "a voluminous mass of evidence" as to the *property* (R. 38) and "a large mass of evidence" as to the earnings (R. 39).

Having been defeated in many of its contentions on the facts and the law, by the Commission, the City announced its intention to contest and review in the State Courts the Commission's November findings and order (R. 39). The City instituted an action for this purpose, early in 1924, but has not prosecuted any such action, as to either the January valuation or the November valuations; it seeks instead to review such orders and valuations *collaterally*, as an *intervenor* in this action.

The City's statement of its reasons for intervention

The City's reasons for intervention here were accurately but rather startlingly stated by it (italics ours):

> "Your petitioner *is informed* and believes * * * that such evidence as it is prepared to produce on a hearing of this cause, *can be presented without embarrassment only by the City or by some party not estopped or embarrassed by the order of the Public Service Commission*" (R. 40).
>
> "It is believed, and therefore averred, that said Public Service Commission, *because of such facts and its knowledge of them and because of its order,* would be embarrassed by and *would be estopped* from making full defense in this cause and would be embarrassed by and estopped from introducing certain important evidence in defense" (R. 39).
>
> "That said Commission is a body exercising quasi-judicial, legislative and administrative functions, charged with *equal duties of protecting the utility and the public* in controversies between them, and as such has, under the law creating and controlling it, *no financial or other interest of a material character in defending against the injunction sought by the complainant water company*" (R. 39).

The City seeks collateral review of the Commission's order and valuation

On its own motion the City came into this cause *as a defendant,* and it is therefore clearly bound by the testimony of the defense witnesses. As an intervenor, under Rule 37, its attitude in this action must be subordinate to and consistent with the defense of the order and findings made by the *real* defendant. (See cases cited, *supra.*)

The City may not intervene and then appeal for the

avowed purpose of asserting attitudes which the real defendant would be *both embarrassed and estopped* in contending herein. The City may not rove about in this record as a "free lance," siding with the Commission on the points decided against the company, repudiating the Commission's findings on other points, accepting some of the Commission's witnesses, impeaching others, and attempting in this manner to attack and review collaterally the Commission's findings and order. *Cf. Central Trust Co.* v. *McGeorge*, 151 U. S. 129; *Re Metropolitan Railway Receivership*, 208 U. S. 90, and other cases cited, *supra.*

Under the various subdivisions of this brief, we shall show that although the only real, necessary or proper *defendant* herein is the Public Service Commission, *the only real appellant* here is the City of Indianapolis, which seeks to divert attention from the Commission's flagrant errors of determination *against the company* by renewing in this Court the contentions as to which the Commission ruled against the City, and as to many of which the Indiana Supreme Court had previously ruled against both the Commission and various municipalities of the State.

The appellants' brief, although filed ostensibly in the name of *both* the City and the Commission, proceeds almost exclusively along lines as to which the Commission would be both embarrassed and estopped, should it try to make any such contentions.

We submit that *the Commission is estopped* as to these matters, as the City has alleged it to be (R. 39-40), and that the City, *as an intervenor,* may not here attack or review the Commission's findings, along lines reviewable at its instance only in the State Court (R. 39).

Standing of the witnesses

The identity and experience of the witnesses called by the respective parties furnish a reliable guide to the merits of the issues.

For the City of Indianapolis:

On valuation and rate of return (R. 31), the Commission must have disregarded the facts presented by its own chief engineer (Mr. Carter) and accepted the guidance of the Bemis's, son and father. Even on rate of return, Professor Edward W. Bemis was heralded by the Commission as "a competent witness on the subject" and his estimate of seven per cent. was accepted exactly (R. 31).

Professor Bemis and his son Walter were the only witnesses called by the City as to the appellee's property. Walter has had experience only in appraisal work for his father (R. 156); aside possibly from Professor Bemis' connection with the Cleveland water department (which ended in 1909), neither has had operating experience entitling him to speak from knowledge, judgment or experience (R. 156, 162). Their testimony was only in support of their theories that the "rate base" should be a grossly-abbreviated "original cost"; neither of them gave testimony that constitutes "a useful guide" to the present property, its condition, or its value. Their whole testimony came fairly within the disqualification so trenchantly pronounced by Circuit Judge Lewis in

> *Westinghouse Electric and Mfg. Co.* v. *Denver Tramway Co.*, 3 Fed. (2nd), 285.

The only witness called by the City as to the appellee's operations, to give support to the City's conjectured *increase* of the appellee's revenues and *decimation* of its ac-

tual expenses, was Benjamin Perk (R. 146), whose only qualification was that he had been "on the accounting staff of the Commission from 1917 to 1919, with the exception of ten months," and that he has since been employed by others to do similar work (R. 146).

For the Commission:

The only witness of *practical experience* called by either of the present appellants was the Commission's chief engineer, Mr. Earl Carter, who had been with the Commission since 1917 (R. 125). *Necessarily,* the brief now filed in the name of the Commission and the City is mainly devoted to "discrediting" Mr. Carter's testimony and to challenging it as "self-impeaching" (R. 63).

As already shown, the testimony of Mr. Carter showed for the appellee's *physical property alone* a valuation of $19,500,000,[1] based on 1923 construction costs, wages and prices (R. 132), or a valuation of $21,051,000,[1] if to Mr. Carter's "bare-bones" figure were added even the Commission's meager allowance for working capital, going value, water rights, etc. (R. 242).

In finding a value of no more than $15,260,400, and limiting the appellee's rates accordingly, the Commission plainly ignored both the law and the testimony of its own chief engineer, whom it sponsored before the District Court as a competent and trustworthy witness (R. 125).

In this Court, counsel for the Commission and the City try to justify their repudiation of Mr. Carter's figure by deducting therefrom numerous theoretical and arbitrary deductions urged by the Bemis's, father and son, unrelated to present value, and *rejected even by the Commission in its quasi-judicial capacity.*

---

[1] As shown on page 30, *post,* these figures do not include land at present market value.

The only other witness called by the Commission was its accountant, Mr. Boggs (R. 145), who presented data as to the early corporate history of the appellee, and also an audit of operations from January 1, 1923, to March 31, 1924 (R. 145, 146, 308).

The exhibit embodying this audit was stated by him to show "the identical gross income figures for 1922, 1923, and 1924 that are shown by Mr. Jirgal's audit in behalf of the company" (R. 146).

For the company:

The engineering firms presenting testimony in behalf of the company were admitted by the Commission to be "each of national reputation and unquestioned standing" (R. 240), based on many years of practical experience. The witnesses included:

Mr. William J. Hagenah, whose appraisal work is so well-known for its conservatism and reliability that he frequently is employed by municipalities and commissions (R. 70).

Mr. Cecil F. Elmes, Middle Western manager of the well-known firm of Sanderson & Porter, consulting engineers and utility operators, himself an engineer of international experience (R. 91).

Mr. Leonard Metcalf, a distinguished engineer (now deceased) who long had specialized in water works and sanitary engineering, and had been familiar with the appellee and its operations and costs, as its consulting engineer since 1907 (R. 114).

Mr. John C. McCloskey, who had been in the real estate business in Indianapolis for thirty years, and has acted as appraiser for the State (R. 124). He was the only witness

called by any one to testify as to the *present market value* of the land, and it cannot be claimed that the Commission's valuation, or even the $19,500,000 figure presented by the Commission's engineer for the physical property (depreciated), gave effect to, or took into account, the market value of the company's land. (See page 30, *post*).

Mr. John Jirgal, a certified public accountant, who presented various accounting tabulations from the books, as to expenses, revenues, taxes, and the like (R. 110, 243, 244, 245).

ARGUMENT

I

THE TRIAL COURT'S VALUATION OF NOT LESS THAN $19,000,000 WAS ON A MINIMUM AND MOST CONSERVATIVE BASIS.

In refusing to allow the appellee to put in force the rate schedule which the owners and managers of the property had formulated in the exercise of their sound business judgment, the Commission disregarded at least two constitutional restraints upon its regulatory jurisdiction:

> (1) The Commission had no power or authority to interfere with the rates promulgated by the company, unless and until the Commission found and determined, *from the evidence*, that the proposed rates would be unreasonable and excessive[1]; and

[1] See
Walker Brothers Catering Co. v. *Detroit City Gas Co.*, 230 Mich. 564; *Coplay Cement Mfg. Co.* v. *Public Service Commission*, 271 Pa. 58; 114 Atl. 649; *Illinois Bell Telephone Co.* v. *Commerce Commission*, 304 Ill. 357; 136 N. E. 676; 306 Ill. 109; 137 N. E. 449; *Wichita R. R. and Light Co.* v. *Public Utilities Commission*, 260 U. S. 48; *Streator Aqueduct Co.* v. *Smith*, 295 Fed. 385; *Public Service Commission* v. *Pavilion Natural Gas Co.*, 232 N. Y. 146; 133 N. E. 427; *City of Edwardsville* v. *Illinois Bell Telephone Co.*, 310 Ill. 618; 142 N. E. 197.

(2) In exercising "the delicate and dangerous function[1]" of fixing new rates to be substituted for those representing the business judgment of the owners of the property, the Commission could not make them such as to yield less than an *adequate* return upon the value of the property at and after the taking effect of the new rates.

In adopting the sum of $19,000,000 as a *minimum* valuation for the purpose of testing the confiscatory character of the rate limitations in controversy, the learned District Judge did not fix what he regarded as the *full* present value of the appellee's property, but accepted a figure which the appellee had recognized as below the realm of fair controversy but sufficient to demonstrate the inadequacy of the Commission's rates. The proofs called for, and would clearly have sustained, a figure substantially in excess of $23,000,000, as Judge Geiger indicated and as we will proceed to show.

The rule of present value

The *value* of utility property, at the time of its use in the public service, is not controlled by any artificial rules or formulas; any facts relevant to its ascertainment in the particular case must be given reasoned, reasonable and actual consideration; but *value* at the time of inquiry is not measured or determined by *cost* at the time of original purchase or construction. "Reproduction value is not a matter of outlay, but of estimate, and * * * proof of actual expenditures originally made, while it would be helpful, is not indispensable[2]." If much time has elapsed since original purchase or construction, original cost is "not a useful guide" to present value.

---

[1] *City of Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, 18; *Louisiana Water Co.* v. *Public Service Commission*, 294 Fed. 954, 957.
[2] *Ohio Utilities Co.* v. *Public Utilities Commission of Ohio*, 267 U. S. 359.

Although the historic rule of value is embodied in the maxim, recently quoted by this Court, that "the worth of a thing is the price it will bring," both the common law and our statute law have, in many relationships, recognized that if the property has not an ascertainable market value (a contemporaneous sale price established under circumstances which make it a fair criterion of the present worth of the *property*), "other evidence is resorted to"; and "cost of reproduction at the date of valuation" has come to be recognized as the starting-point and the most influential factor in giving "due regard to construction costs, conditions, wages and prices affecting value" at the date of the inquiry.

Standard Oil Co. v. *Southern Pacific Co.*, 268 U. S. 146;

State of Missouri ex rel. Southwestern Bell Telephone Co. v. *Public Service Commission of Missouri*, 262 U. S. 276;

Ohio Utilities Co. v. *Public Utilities Commission of Ohio*, 267 U. S. 359;

Brooks-Scanlon Corporation v. *United States*, 265 U. S. 106, 125;

Bluefield Water Works and Improvement Co. v. *Public Service Commission of West Virginia*, 262 U. S. 679;

Monroe Gas Light and Fuel Co. v. Michigan Public Utilities Commission, 292 Fed. 139; (Spec. Stat. Ct.); ruling reaffirmed on further hearing: —— Fed. (2nd) ——; decided February 27, 1926;

Matter of Peoples' Gas and Electric Co. of Oswego v. *Public Service Commission*, 214 App. Div. (N. Y.) 108;

The Van Wert Gas Light Co. v. *Public Utilities Commission of Ohio,* 299 Fed. 670;

Roanoke Waterworks Co. v. *Commonwealth of Virginia,* 124 S. E. 652 (Va.);

New York Telephone Co. v. *Prendergast,* 300 Fed. 822 (Spec. Stat. Ct.); S. C. on further hearing: Fed. (2nd) ; decided March 10, 1926;

Petersburg Gas Co. v. *Petersburg,* 132 Va. 82;

Consolidated Gas Co. v. *Newton,* 267 Fed. 231, 236; 258 U. S. 165;

City of Erie v. *Public Service Commission,* 278 Pa. St. 512; 123 Atl. 471;

Citizens' Gas Co. of Hannibal v. *Public Service Commission of Missouri,* 8 Fed. (2nd) 632;

Elizabethtown Gas Light Co. v. *Board of Public Utility Commissioners of New Jersey,* 111 Atl. 729;

City of Fort Smith, Ark. v. *Southwestern Bell Telephone Co.,* 294 Fed. 102; —— U. S. ——; 46 Sup. Ct. Repr. 206; 70 L. Ed. 236; affirmance by this Court on January 25, 1926.

The law of the State of Indiana, which should control *both* of its creatures (the City and the Commission), is in accord with the prevailing State and Federal rule on this subject, as above summarized.

Columbus Gas Light Co. v. *Public Service Commission of Indiana,* 193 Ind. 399; 140 N. E. 538.

As to the property of water companies, the law as to the basis of its valuation was settled by this Court in the *Denver Water Company* case (246 U. S. 178):

"What we have said establishes the propriety of estimating complainant's property on the basis of present market value as to land and reproduction cost, less depreciation, as to structures."

(A) The Trial Court's minimum valuation of not less than $19,000,000 is less than the sums shown by the uncontradicted evidence as to the various elements of the property:

This Court has held, in the *Ohio Utilities Company* case, and the appellants' brief admits (page 55), that reproduction cost at present wages and prices must be given not only dominance, but controlling and exclusive weight, where there was before the fact-finding tribunal no other evidence pertaining to *present value*. Even the appellants admit that uncontradicted evidence "cannot be capriciously disregarded." The proofs before Judge Geiger may appropriately be analyzed, in first instance, according to this test:

The facts

The proofs submitted to the District Court, in relation to the 1923-24 value of the company's property, were of two kinds:

(1) Appraisals based on "construction costs, conditions, wages and prices affecting value," as of 1923 and early 1924; and

(2) Appraisals based on the application, to the December 31, 1923, inventory, of unit prices *averaged* over some period of time, either a period averaging the present price level or a period giving substantial or even dominant weight to *pre-war rather than present costs.*

All of the various estimates which gave any weight whatever to wages, prices and construction costs during

1922, 1923, or 1924, were summarized on pages 8 to 11, *ante;* and $19,000,000 was shown to be a most conservative and minimum figure.

The decree of the District Court in fact found (R. 56) that the appellee had sustained and proved the material averments of its complaint, which included an allegation that (R. 5)

> " if the 'spot' value of labor and material during the year 1923 should be applied in determining the fair value of its property owned throughout that year, and used and useful in its public service business the fair value of such property was and is in excess of $22,000,000" (R. 5).

As reviewed on pages 8 to 11, *ante,* this allegation was abundantly supported, by the appellee's evidence and even by the testimony of the Commission's own chief engineer. Mr. Hagenah's Exhibit No. 2 (R. 180; fol. 218) showed $26,521,615 as the reproduction cost new of the property at prices as of December 31, 1923. Less all depreciation, this figure became $25,404,026. The same exhibit also gives a comparison of his appraisal results at prices averaged over three-year, five-year and ten-year periods, ended December 31, 1923. These figures, for the property depreciated, range from $25,387,799 to $22,359,354 (R. 180; fol. 218).

Mr. Elmes' Exhibit No. 10 (R. 194) gives his estimates on similar bases, his figure as of December 31, 1923, being $23,202,951 for the physical property plus $2,598,000 for going value and water rights, *less* $443,044 of restoration cost—a value of $25,357,907 for the total property as of that date (R. 194).

We will proceed to show that acceptance of the *lowest* figures shown by the *uncontradicted* testimony as to the

various elements of the property, would inescapably produce a total substantially in excess of $19,000,000 and closely approximating $23,000,000.

(1) The structural property

The District Court's minimum figure of $19,000,000 was less than the *undisputed* testimony as to the value of the *physical property only,* at 1923-24 prices, *after* deducting depreciation but *before* making any allowance for going value, for working capital other than materials and supplies, or for water rights.

The following table shows the estimates given by the only witnesses who testified as to present value:

Valuation of physical property only, at 1923-24 prices

Witness	*Replacement new*	*Present value (depreciated)*
Mr. Hagenah for Company	$23,786,615	$22,669,026 (R. 180)
Mr. Elmes for Company	22,341,706	21,898,662 (R. 194)
Mr. Carter for Commission		19,500,000 (R. 132)
Average	$23,064,160	$21,355,896

Messrs. Elmes, Hagenah and Carter also presented various informative and corroborative estimates of the replacement cost of the December 31, 1923, inventory of physical property, priced on the basis of *averages* which gave diminished weight and effect to the wages and prices prevailing as of 1923. These estimates, at averaged unit prices, were:

Valuation of physical property only, at averaged unit prices

Five-year average ending 1923:

	Replacement new	*Present value (depreciated)*
Hagenah for Company...	$23,769,443	$22,652,799 (R. 180)
Elmes for Company.....	22,306,902	21,863,858 (R. 194)

Three-year average ending 1923:

	Replacement new	*Present value (depreciated)*
Hagenah for Company...	$22,682,204	$21,625,358 (R. 180)
Elmes for Company	21,411,171	20,968,127 (R. 194)

Ten-year average ending 1923:

	Replacement new	*Present value (depreciated)*
Hagenah for Company...	$20,564,739	$19,624,354 (R. 180)
Elmes for Company	19,375,023	18,931,979 (R. 194)
Carter for Commission ..		17,006,370 (R. 132)

On no basis which gave any weight whatever to 1923 wages and prices, did any witness present any estimate of value which appraised the appellee's *physical property only* (less depreciation) at less than $17,006,370 (R. 132), exclusive of going value, water rights, and working capital other than materials and supplies. Even this figure was testified to by the Chief Engineer of the appellant Commission and was derived by him from a *ten-year* average, beginning with January 1, 1914, which thereby gave predominant weight to prices before the post-war period.[1] Yet even this *minimum* figure for the physical property was nearly $2,000,000 above the total value which the Commission placed upon all of the property.

[1] In fact, as to the years 1917 and 1920, Mr. Carter did not prepare his ten-year average by accepting the "peak" prices for those years (R. 132), but included them at the average between the year preceding and the year following (R. 132).

Any reasonable allowance for going value, working capital, and water rights, based on the testimony in this case, would bring even this partly pre-war figure to approximately $20,000,000.

The District Court was clearly right in indicating that the present value of the appellee's property was fully $23,000,000, instead of the $19,000,000 adopted by it as sufficient for the purposes of this case.

(2) Value of land (unimproved)

The appellee's testimony as to the value of its land (unimproved) as of the time of the hearing, was uncontradicted in the District Court. The only testimony on this subject was given by Mr. John McCloskey, a real estate man of long experience, who has done appraisal work for the State of Indiana (R. 124).

Mr. McCloskey's land valuation was not attacked and stands uncontradicted, the only evidence of the market value of the appellee's land as of 1923 or January 1, 1924. His total land values amounted to $3,014,647 (R. 124, 261). Mr. Carter's figure of $19,500,000 for the physical property included the land at $2,949,438 (R. 131), or $65,209 less. Mr. McCloskey included no item for accumulation of right of way of canal, made no allowance for the company's easement over overflow lands above the dams, and included no overhead upon the lands (R. 124 and 261). These elements of the land Mr. Carter had valued at $280,000 (R. 128).

The figure used by Mr. Carter for land (R. 131) was, therefore, $345,209 less than the uncontradicted testimony as to the value of the land as of the date of the trial in the District Court. Correcting Mr. Carter's reproduction value of $19,500,000 by adding the $345,209 which he left out of the land value, we have $19,845,209 as the Commission's chief engineer's corrected appraisal of *physical property only* (depreciated), at 1923 wages and prices.

(3) Undistributed structural costs (overheads)

There was no conflict of testimony in this case as to the reasonable and proper allowance for the undistributed structural costs (overheads). Chief engineer Carter, for the Commission, testified to and used 15 per cent. (R. 126, 128, 133), and Messrs. Hagenah and Elmes testified to no higher figure, although they showed that at least 15 per cent. would reasonably be required for actual needs (R. 72, 81). Mr. Elmes testified that he thought 15 per cent. was "dangerously low," and that his company used twenty-five per cent. for construction work (R. 93). Mr. Carter figured his 15 per cent. upon all of the physical property except materials and supplies (R. 133), and indicated that a higher percentage would be necessary if the percentage was not applied to a sum which included the land. In testifying to and using the allowance of 15 per cent., Mr. Carter only followed common Commission practice and was supporting the figure which the appellant Commission had itself approved and deemed applicable to the appellee (R. 229).

Although the witnesses and the Commission had agreed upon a 15 per cent. allowance, which would amount to about $2,500,000 (figured upon Mr. Carter's minimum value of physical property at 1923 prices), it is impossible to find any trace of or allowance for these undistributed costs at all, in the Commission's valuation of $15,260,400 for *all* the property.

Moreover, in view of the facts set out on pages 28 to 30, *ante*, as to the testimony as to the 1923 value of the physical property alone (the minimum figure, given by Mr. Carter, totalling $19,500,000), it would be difficult to find any fifteen per cent. included for these undistributed but actual costs, in the $19,000,000 figure suggested by the Company, and found by the Court, as sufficient for the purposes of this case.

It is now well established that the exclusion of these items, or their reduction to amounts below what the evidence justifies, is a serious error, on the part of a Commission or Court.

In *Ohio Utilities Co.* v. *Public Utilities Commission of Ohio* (267 U. S. 359), this Court reversed the Ohio Commission for ignoring undisputed estimates of allowances for undistributed costs, and said:

> "Reproduction value, however, is not a matter of outlay, but of estimate, and should include a reasonable allowance for organization and other overhead charges that necessarily would be incurred in reproducing the utility."

In *New York and Richmond Gas Co.* v. *Prendergast* (10 Fed. [2nd] 167; P. U. R. 1925 E, page 19), decided on November 24, 1925, the Special Statutory Court took similar action, by way of increasing an inadequate allowance by the Special Master and said:

> "These costs are for *actual* expenditures. They are *inescapable* outlays of money. They were principally construction overhead charges but they were actual costs and go into the fair value as would any labor or material costs."

The nature of these elements of actual cost were excellently explained by Chairman Towers of the Maryland Commission in *Re Chesapeake and Potomac Telephone Co.*, P. U. R. 1916C, pages 925, 951. In fact, even the opinion of the appellant Commission in the present case (R. 17-19) is a refutation of what the appellant *did* as to "structural overheads"; it answers persuasively the arguments now advanced by counsel for the Commission and the City.

The allowance of fifteen per cent. shown by the undisputed testimony would have been low

In fact, if the Commission and the District Court had followed the undisputed testimony and allowed 15 per cent. for these undistributed costs, that allowance would have been on a most conservative basis.

In *New York and Richmond Gas Company* v. *Prendergast (supra)* the Special Master cut the allowance for these items to 19 per cent., but the Special Statutory Court unanimously increased the allowance to 31 per cent.

In *Milton* v. *McGowan W. Lt. & P. Co.* (P. U. R. 1923A, page 755), the Wisconsin Railroad Commission allowed 25 per cent. for these items.

In *Re Idaho Power Company* (P. U. R. 1923B, p. 52), the Idaho Commission allowed for these items 31 per cent.

In *The Bronx Gas and Electric Company* case, in the New York State Supreme Court, the allowance for undistributed structural costs amounted to 31 per cent. of the cost of the tangible property, and the Appellate Division, on February 21, 1924, unanimously affirmed these findings (28 N. Y. State Dept. Repts., page 329; P. U. R. 1923 A, page 255; 208 App. Div. 780).

The New York State Public Service Commission, in *The Bronx Gas and Electric Company* case, before it in 1915, appears to have allowed 34 per cent. for these items (6 State Dept. Repts., pages 76, 94). The Commission reviewed various decisions in which allowances had been included in appraisals of amounts aggregating from 20 to 21½ per cent. for contractors' profits, engineering, supervision, administration, contingencies, etc., and from 10 to 20 per cent. for preliminary and development expenses, organization, interest and taxes (*Id.* pages 102-103).

In *Okmulgee Gas Co.* v. *Corporation Commission* (95 Okla. 213; 220 Pac. 33), the allowance for "overheads" was 20 per cent.

In *Brooklyn Union Gas Company* v. *Prendergast* (7 Fed. [2nd], 628, 659), Judge Campbell allowed a little more than 20 per cent. for these undistributed structural costs.

In the valuation by the Great Britain Railway and Canal Commission of the property of the National Telephone Company, the Commission added 31.4 per cent. of the reproduction cost of over ten million pounds sterling. The case is reported in 16 *A. T. & T. Co.*, Com. L. 491.

In the *Kings County Lighting Company* gas-rate case (2 P. S. C. R., 1st Dist., N. Y. 659), years before the war, the New York Commission allowed for these items 21.8 per cent.

Mr. L. R. Nash, in a pamphlet published in Stone & Webster's *Public Service Journal*, in October of 1912, entitled "Valuation of Public Service Properties," records that:

> "A special commission in Massachusetts used 23 per cent. in its valuation of the electric railway properties of the New York, New Haven & Hartford Railroad. The Washington Commission has used 28 per cent. in an electric railway rate case. The Traction Valuation Commission used 25 per cent. in appraising the Chicago surface railways. The Boston Transit Commission found the actual cost of its work of designing and constructing the Boston subways was 23.6 per cent. of the physical costs, not including brokerage and some other costs encountered in private work."

In *New York and Richmond Gas Co.* v. *Nixon* (203 App. Div. 860; 204 App. Div. 838, 894), decided in January of 1921, Ex-Justice Albert H. Sewell, formerly of the New York

Appellate Division for the Third Department, allowed fifteen per cent. for these "overheads," and the distinguished official referee did so upon Mr. Hagenah's testimony.

On pages 73 to 76, *post*, we will discuss briefly the unsound grounds on which the appellant Commission and the appellant intervenor try to eliminate altogether the 15 per cent. to which even the Commission had held the appellee to be entitled (R. 229).

(4) Going value, working capital, and water rights

For these three classes of the appellee's property, the Commission's order of November 28, 1923, allowed only $980,000 (R. 22). As we shall proceed to show, $980,000 would have been a *conservative* allowance for working capital and water rights alone, wholly apart from going value, or would have been an inadequate and meager allowance for going value alone, with no inclusion whatever for working capital or water rights.

The lowest estimate of going value, embodied in competent testimony, was $2,000,000 (R. 73). The lowest estimate of working capital, on *any* basis, was $235,000 (R. 72), including materials and supplies; as shown on pages 48 to 52, *post*, the lowest, on a basis conforming to the recent decisions, was $361,245 (R. 194). The lowest estimate for water rights was a minimum of $500,000, palpably a fraction of their real worth (R. 72, 73, 95-98, 195-201).

Therefore the learned District Judge was fully justified in finding, from the evidence before him, that the Commission had not made a proper allowance for these items. As a matter of fact, however, the $19,000,000 minimum figure adopted by the District Court seems to have been made up on the basis of including no more than $1,416,000 for going value and water rights (instead of the undisputed es-

timate of $2,500,000) and $135,000 for cash working capital (instead of Mr. Elmes' estimate of $233,306). So it seems to us clear that the District Court's $19,000,000 is in itself *a conservative and minimum figure, even though sufficient for the purposes of the present case.*

We will proceed with discussion of these three items of property *seriatim:*

(i) Going value:

In the *Des Moines Gas Company* case (238 U. S. 153, at 165), this Court defined going value as being "the value which *inheres* in a plant where its business is established as distinguished from one which has yet to establish its business." It also there said that in such a plant *that element* of value is "*self-evident,*" and "should be considered in determining the value of the property upon which the owner has the right to make a fair return."

This Court has never refused to uphold an allowance for going value, when its existence has been demonstrated under this definition and competent proof has been offered from which the present worth of this element of property may reasonably be appraised. *The propriety of such an allowance has long been recognized as to water companies.* It is now the consensus of opinion and authority, in both the Federal and the State Courts, that an adequate allowance for the going value of a utility property must be made, according to the proofs, in a rate or confiscation case as in any other.

> *City of Fort Smith* v. *Southwestern Bell Telephone Co.,* 294 Fed. 102; U. S. ; 46 Sup. Ct. Repr. 206; 70 L. Ed. 236; affirmance by this Court on January 25, 1926;

Bluefield Water Works and Improvement Co. v. *Public Service Commission of West Virginia,* 262 U. S. 679;

Galveston Electric Co. v. *City of Galveston,* 258 U. S. 388;

Westinghouse Electric and Manufacturing Co. v. *Denver Tramway Co.,* 3 Fed. (2nd), 285;

Monroe Gas Light and Fuel Co. v. *Michigan Public Utilities Commission,* Fed. (2nd) (Special Stat. Ct.); decided February 27, 1926; S. C. on preliminary injunction: 292 Fed. 139;

Matter of People's Gas and Electric Co. of Oswego v. *Public Service Commission,* 214 App. Div. (N. Y.) 108;

New York Telephone Co. v. *Prendergast,* 300 Fed. 822 (Spec. Stat. Ct.); S. C. on further hearing: Fed. (2nd) ; decided March 10, 1926;

Denver v. *Denver Union Water Co.,* 246 U. S. 178;

Omaha v. *Omaha Water Co.,* 218 U. S. 180;

National Water Works Co. v. *Kansas City,* 62 Fed. 853, 865;

State Public Utilities Commission v. *Springfield Gas and Electric Co.,* 291 Ill. 209;

Streator Aqueduct Co. v. *Smith,* 295 Fed. 385;

Lincoln Gas Co. v. *Lincoln,* 250 U. S. 256, 267;

Venner v. *Urbana Water Co.,* 174 Fed. 348;

Michigan Public Utilities Commission v. *Michigan State Telephone Co.,* 228 Mich. 658; 200 N. W. 749;

Town of Milton v. *Railroad Commission of Wisconsin,* 185 Wisc. 294; 201 N. W. 381;

Consolidated Gas Co. v. *Prendergast,* 6 Fed. (2nd) 243;

Southern Bell Telephone and T. Co. v. *Railroad Commission of South Carolina,* 5 Fed. (2nd) 77, 87;

Citizens' Gas Co. of Hannibal v. *Public Service Commission of Missouri,* 8 Fed. (2nd) 632;

Kings County Lighting Co. v. *Prendergast,* 7 Fed. (2nd), 192;

Columbus Gas Light Co. v. *Public Service Commission of Indiana,* 193 Ind. 399; 140 N. E. 538.

An appraisal of going value must be the product of an informed judgment. To the practical mind, going value is an existing property, in the same sense that buildings, lands and equipment are property. The potentiality of the service supplied by the going business is the property of the owner just the same as the potentiality of the physical property. The enumeration of the elements of that potentiality, although difficult, is inclusive of myriad items. To the man of experience, judgment and reason, the value is apparent and capable of being fixed. The fact that difficulty is experienced in reaching an exact, mathematical determination, does not deter a legal ascertainment of value, for tangible or intangible elements.

Wakeman v. *Wheeler and Wilson Co.,* 101 N. Y. 205.

For failure to allow going value, the Supreme Court of Illinois *(Springfield Gas Company* case, *supra)* reversed the Illinois Commission, *notwithstanding the latter's express declaration it had considered going value,* the Court saying (pages 223, 231):

"From the nature of this element of value, it can not be arrived at with mathematical accuracy, but

must necessarily be considered in the light of the facts of each particular case."

The Indiana statutes and decisions require the Commission to make an adequate allowance for going value, under the definition of the *Des Moines* case.

There is no question in this case as to whether going value should have been determined and included as a part of the appellee's property. The Indiana statute and the Indiana Supreme Court have so directed, and the appellant Commission has so determined.

In Section 9 of the Indiana Public Service Act, it is provided: "As one of the elements of such valuation, the Commission shall give weight to the reasonable cost of bringing the property to its then state of efficiency" (Burns' R. S. 1914; Sec. 10052, i). In Section 31 of the same Act (Burns' R. S. 1914; Section 10052, e 1), the Commission is required to recognize the value of the intangible, as well as the tangible, property of each utility.

In setting aside, in June of 1923, a valuation made by the appellant Commission without adequate allowance for going value (R. 25-27), the Supreme Court of Indiana expressly ruled that the company was entitled to have its going value included as a part of its "rate base" and quoted and adopted the definition given in the *Des Moines* case, as the basis on which the Commission must determine and allow it.

> *Columbus Gas Light Co.* v. *Public Service Commission,* 193 Ind. 399; 140 N. E. 538.

The statutes of Indiana thus expressly directed the appellant Commission to make an allowance for going value, as a part of the properties on which utility rates must yield

a fair return, and the highest Court of law in the State has directed *this duty and its actual performance*, by the appellant Commission. *Neither of the present appellants could be heard to make their present contentions in the State Courts.*

The Commission found that the appellee has going value

The appellant Commission has itself found and determined that the appellee possesses going value, which should be included in its "rate base." In its order (No. 6613) of January 2, 1923, it said (R. 235):

> "Any reasonable man with a knowledge of this property and the local conditions would unhesitatingly affirm that it had a value far in excess of the value of the pipe, buildings, grounds and machinery. Consider its earning power with low rates, the business it has attached, its fine public relations, its credit, the nature of the city and the certainty of large future growth, the way the property is planned and is being extended with the future needs of the city in view, its operating efficiency and standard of maintenance, its desirability as compared with similar properties in other cities and with other utilities of comparable size in this city. *These things make up an element of value that is actual and not speculative.*"

The Commission then fixed such value, in conjunction with water rights, at $1,416,000 (R. 242). Even in the order (No. 7080) here complained of, entered on November 28, 1923, the Commission *said* (R.19):

> "further citation of authorities is deemed unnecessary as such a value attaching to such a utility *as the one under consideration* is generally accepted, as it is admitted by all parties *that this utility functions efficiently and renders good service and is a profitable institution,*"

yet its total allowance for *going value, water rights and working capital was only $980,000* (R. 22) or $571,000 less than it had previously allowed for these three items.

In its opinion in the present case, the Commission admitted that although it still recognized the *existence* of going value in the appellee's property (especially in view of its recent reversal by the Indiana Supreme Court in the *Columbus Gas Light* case, *supra*), the percentage allowed for going value was "*smaller than is usual in such cases*" (R. 22), and *unexplainedly* much smaller, *both in dollars and in percentage*, than the Commission itself had allowed when the appellee's property and business was smaller.

Before this Court, counsel for the Commission undertakes to argue that the District Court should have included no allowance whatever for going value, despite the Commission's finding that the appellee possesses going value and should be allowed for it!

The evidence and findings as to going value in this case

What part, *if any*, of the $980,000 allowed by the Commission for going value, working capital, and water rights, represented *going value*, no one can say, as the Commission did not.

For these three items, the Commission allowed only 6.4 per cent. of its own valuation, and only *five* per cent. of its own chief engineer's 1923 valuation of the *physical property* depreciated. A *reasonable* allowance for working capital and water rights, upon this record, would absorb the whole $980,000, leaving *nothing* for going value (which is probably what the Commission really did). Viewing the whole $980,000 as an allowance for going value alone, the above-stated percentages are absurdly low.

The lowest estimate of going value that was presented by any witness was $2,000,000 (R. 73, 84, 85, 95). The same evidence of going value was presented to the Commission and the District Court. Judge Geiger fixed for *all* of the appellee's property a value of not less than $19,000,000—a figure which was apparently reached by including not more than $1,416,000 for *both going value and water rights* (R. 86). This sum for both items represented only 7.4 per cent. of the District Court's valuation. The *uncontradicted* testimony as to the water rights valued them at the minimum sum of $500,000, which would leave only $916,000 for going value. This sum last-named is only 4.8 per cent. of the Commission's valuation.

An allowance of at least ten per cent. for going value is a minimum.

Each of these percentages demonstrates the utter inadequacy of the allowance made for going value. In the *City of Fort Smith* case, affirmed by this Court on January 25, 1926, the finding for going value amounted to approximately 15½ per cent. of the reproduction cost new of the tangible property. In the *Bluefield* case, the allowance for going value exceeded *ten* per cent. In *New York and Richmond Gas Company* v. *Prendergast, supra,* the Special Statutory Court made findings which allowed for going value more than *fifteen* per cent. of the reproduction cost new of the tangible property (excluding working capital but including undistributed costs) or about *sixteen* per cent. of the total present value of such property as found by the Court. In *Southern Bell Telephone Co.* v. *Railroad Commission of South Carolina* (5 Fed. [2nd], 77), the allowance for going value was in excess of eleven per cent. of the physical property. In *Citizens' Gas Co. of Hannibal* v. *Public Service Commission of Missouri* (8 Fed. [2nd] 632, 634), the allowance by Judge

Reeves for going value was 14 per cent. of the value fixed by him for the tangible property.

Many Federal and State determinations might be cited in which more than *ten* per cent. has been allowed for going value; but an examination of the decisions discloses that where conflicting and contested proofs have been presented, "the Courts have generally found an amount approximating ten per cent. of the sum found as the value of the tangible property, as fairly representing the going value."

> *Streator Aqueduct Co.* v. *Smith,* 295 Fed. 385;
> *Consolidated Gas Co.* v. *Prendergast,* 6 Fed. (2nd) 243;
> *Greensburg Water Co.* v. *Indiana Public Service Commission* (decided February 19, 1926; Charles Martindale, Master in Chancery); not yet officially reported;
> *Mobile Gas Co.* v. *Patterson,* 293 Fed. 208;
> *Monroe Gas Light and Fuel Co.* v. *Michigan Public Utilities Commission, supra;*
> *Citizens' Gas Company of Indianapolis* v. *Public Service Commission of Indiana* (report of William P. Kappes, Special Master; filed May 15, 1922; confirmed by Anderson, *C.J.;* not officially reported).

In the *Monroe Gas Light Company* case, before Denison, *C.J.*, and Tuttle and Simons, *D.JJ.*, the *per curiam* opinion filed on February 27, 1926, said, as to going value:

> "Reported decisions show estimates as high as 25 per cent. or 30 per cent. of the cost of the tangibles. These may be extravagant. Seemingly there is no definite percentage relation. At the same time, the proposition that a plant of this kind and in this business and in successful operation, with customers somewhat permanently attached for its capacity output, is worth 10 per cent. more than the skeleton would cost, seems not unreasonable—no circumstances *contra* appearing."

Usually, as in several of the cases above cited, the Com-

missions do not seriously contest an allowance which does not exceed *ten* per cent. Any adherence to the ten per cent. rule as a minimum, however, is subject to the qualification that the Commission and the District Court *must follow the evidence.* It may not make an allowance so low as ten per cent. unless the evidence warrants it.

Westinghouse Electric & Manufacturing Co. v. *Denver Tramway Co., supra;*
Ohio Utilities Co. v. *Public Utilities Commission of Ohio, supra;*
New York and Richmond Gas Co. v. *Prendergast,* 10 Fed. (2nd.) 167.

In the *Denver Tramway* case, Circuit Judge Lewis held that the Special Master was not in any event justified in reducing the allowance for going value below the lowest estimate which was supported by the testimony.

> "There remains to be added an amount for going concern value. On this subject the City declined to offer any proof. The lowest amount named by a witness for the receiver was $2,900,000 and the highest $4,500,000. The Master allowed $1,500,000. The receiver says he does not know where the Master got this amount, and there is no evidence to support it. The question thus raised is not without difficulty. I confess I have no personal opinion or judgment at all on the subject; every-day knowledge of ordinary affairs does not inform me and is no guide. * * * I am firmly of the notion that each of these witnesses know much more about what it would probably cost to put a skeleton street railway plant in successful operation than I do. I know nothing on the subject. I am sure they each knew a great deal; and I see no escape from accepting the lowest amount named in the testimony."

The uncontradicted evidence here called for a going value allowance of $2,000,000

Mr. Elmes appraised the appellee's going value at $2,098,000. He showed that this was based essentially on the business and the property today—elements and advantages not attaching to a physical property completed and ready to operate (R. 95). He submitted an exhibit *confirming* his opinion and judgment by computations based on a variety of methods commonly used in checking and corroborating estimates of going value (R. 195-201).

Development cost alone, as an element in going value, was estimated by Mr. Hagenah at approximately $2,000,000 as of December 31, 1923 (R. 72, 73, 85). In putting together the minimum figure of $19,000,000 adopted by the Court as sufficient, on an *incontestible* basis, for the purposes of this case (R. 87, 88), Mr. Hagenah included going value (and water rights) at the $1,416,000 figure found by the Commission in its January order of 1923, but this was by way of computation and hypothesis.

Mr. Hagenah's testimony shows conclusively that in arriving at his judgment of going value, at the sum of $2,000,000, he confined himself to the factors defined and approved in the *Des Moines Gas* case, *supra*, and included none that has been disallowed by this Court in any case where it discussed going value. Mr. Hagenah took into consideration the financial history of the Company as suggested in *Houston* v. *Southwestern Bell Telephone Co.* (259 U. S. 318, at 325). He rejected the element of pioneer losses and past deficits (R. 85), discussed in the *Galveston Electric Company* case. He took into consideration the time and expenses involved in the development of the business, the necessity for rearrangement of original plans, the inevitable cost of tuning up and coor-

dinating the properties, the organization of the operating staff and the harmonizing of operation, and the fact that the company has approximately fifty-six thousand customers (R. 73). These are the factors which create an "assembled and established plant doing business and earning money" as distinguished from one which has "yet to establish its business" as announced in the *Des Moines Gas* case.

In *New York and Richmond Gas Company* v. *Nixon* (204 App. Div. 838, 894) Ex-Justice Albert H. Sewell, formerly of the Appellate Division for the Third Department, allowed approximately ten per cent. for going value, *upon the sole support of Mr. Hagenah's testimony, along lines similar to his presentation in this case.*

Notwithstanding the fact that the appellant Commission, in its January (1923) determination, allowed approximately 9½ per cent. for the appellee's going value and water rights (R. 242), and the fact that in the order attacked in the Court below the Commission expressly recognized the existence of going value in the appellee's property and admitted that the percentage which it allowed therefor "is smaller than is usually allowed in such cases" (R. 22), appellants on this appeal contend that if the cost of acquiring the elements of going value was charged to operating expenses, or if it appears that a substantial allowance has been made for undistributed structural costs or overheads, going value will not be given further consideration. They cite the *Des Moines* case in support of such a contention. In that case, this Court was apparently of the opinion that the Master had sufficiently allowed for the cost of bringing the plant to the stage of successful commercial operation, and that therefore it could not be said that he had not thereby given sufficient consideration to going value. There was, however, nothing in the decision that lends support to

the notion that the cost of reproduction of the physical plant and property would, as a matter of law, include the element of going value. "Overheads" were referred to in the *Des Moines Gas* case because this Court apparently interpreted certain language of the Master, quoted in the opinion, as meaning that his allowance for "overheads" embraced some expense of development. The decision seems to have gone no further than to determine that it was not satisfactorily and affirmatively made to appear to the Court that in fixing a figure based upon the actual and successful operation of the plant, there had not in fact been a sufficient allowance for going value in the Court below and in the particular case. This is a wholly different proposition from the contention that the "overheads" contained in Mr. Hagenah's reproduction costs of the physical units embrace the element of going value or any part of such element. An estimate of the cost to build or replace an existing plant or system necessarily includes both the distributed unit costs and the undistributable structural costs, which are an essential part of the total cost of completing the physical property. Such an estimate does not, however, credit the property with the cost of tuning up and coordinating the plant or personnel or the cost of obtaining its established business. The reproduction cost of the physical property assumes only that the plant has been brought to the point of physical readiness to begin operation, so that it may thereafter attach consumers and develop and establish a business.

The amount allowed for going value should not be decreased because partly paid for through operating expenses

It seems well settled now, by many decisions of the State and Federal Courts, that in estimating the amount and present value of the property of a utility, neither the

amount nor the value of the useful property should be diminished by the fact that any part of such property was paid for out of net earnings or even that, in earlier years before regulatory accounting, some part of such property may have been charged directly to operating expenses. This applies to going value as well as to physical property.

Lincoln Gas Co. v. *Lincoln,* 250 U. S. 256, 267;
Michigan Public Utilities Commission v. *Michigan State Telephone Co.,* 228 Mich. 658; 200 N. W. 749;
City of Minneapolis v. *Rand,* 285 Fed. 818, 830;
New York and Richmond Gas Co. v. *Prendergast,* 10 Fed. (2nd) 167;
Grafton County E. L. and P. Co. v. *State,* 78 N. H. 330; 100 Atl. 668.

(ii) Working capital:

The evidence as to the amount needed and used by the appellee for cash working capital and for materials and supplies consisted solely of the testimony of Messrs. Elmes and Hagenah, and the Commission certainly gave a most meager and inadequate allowance for this indispensable and actual element of property.

Mr. Elmes testified to the need for $233,306 for cash and $127,939 for materials and supplies—a total of $361,245 for working capital (R. 94, 194). Mr. Carter, the chief engineer of the Commission, included $102,997 of materials and supplies in his inventory of the actual physical property (R. 262). Mr. Hagenah, because of special circumstances, the legal effect of which we believe he unsoundly conceived, reduced his estimate for cash and materials and supplies to $235,000 (R. 72, 84). In its order of January 2, 1923 (Case No. 6613), the Commission had allowed $135,000

for cash working capital alone, in addition to the inventoried materials and supplies (R. 242) of which Mr. Carter's figure of $102,997 (R. 262) may be taken as representative, making at least $237,997 as a meager minimum for both the elements of working capital.

The lowest estimate of going value, supported in any way by the testimony, was $2,000,000 and of water rights was $500,000, yet this $2,500,000 of undisputed actual property the Commission cut down to $980,000 (R. 22), and threw into the $980,000 figure at least $235,000 of working capital (cash and materials and supplies) for good measure.

The Commission itself recognized the necessity of an allowance for both working capital and materials and supplies in Order No. 7080 and in Order No. 6613 (R. 22 and 236), but it is apparently the contention of appellants here that there should be no allowance for either working capital or materials and supplies, as they propose to deduct the amounts fixed by Mr. Carter for materials and supplies and by Mr. Hagenah for working capital, from their respective appraisals (Brief, pages 81, 83, 87). On page 92, *post*, we refer further to the impropriety of such an elimination.

Here it may be noted that the appellants *assign no reason whatever for making the elimination of the actual materials and supplies found and inventoried by the Commission's engineer.* They base their deduction of Mr. Hagenah's estimate on the fact that Mr. Hagenah found, during the year 1923, that some $831,945 of the revenues had been paid in advance by consumers (R. 84). Mr. Hagenah testified that he took this fact into consideration, and that is why he allowed no more than $235,000 for *both* working capital and materials and supplies (R. 84).

In point of fact, the appellee was and is constitutionally entitled to have the Commission include in its "rate

base" an adequate allowance for working capital—"an amount such as reasonable business men of experience would require in the conduct of this kind of a business."

New York and Queens Gas Co. v. *Newton,* 269 Fed. 277, 284; affd. 258 U. S. 165;

The Bronx Gas and Electric Co. v. *Public Service Commission,* P. U. R. 1923A, 255; 28 N. Y. St. Dept. Repts., 329, 364; affd. 208 App. Div. 780, 806;

Brooklyn Union Gas Co. v. *Nixon,* 2 Fed. (2nd), 118;

New York and Richmond Gas Co. v. *Prendergast,* 10 Fed. (2nd) 167 (Spec. Stat. Ct.); P. U. R. 1925E, 19;

New York and Queens Gas Co. v. *Prendergast,* 1 Fed. (2nd), 351; appeal dismissed 268 U. S. 708;

Kings County Lighting Co. v. *Prendergast,* 7 Fed. (2nd), 192, 198, 217.

The figure of $361,245 estimated by Mr. Elmes corresponds conservatively to the basis on which working capital has commonly been allowed by the Federal and State Courts in rate cases. In none of the cases above cited has the allowance been reduced to a basis comparable with Mr. Hagenah's minimum figure of $235,000, nor has such a reduction been made for any such reasons. At least the first five cases above cited definitely rejected a reduction sought on similar grounds.

The appellee is entitled to earn a return upon all of the property, including materials, supplies, and cash, which it actually possesses and uses in the public service. That amount may not be decreased by any incident of the *source* from which it obtained any of such property, or by the fact

that some of it may not yet have been paid for (see cases cited, *supra*).

The appellants' misapprehension regarding working capital represents a fallacy which has survived from the "investors' sacrifice" theory of the "rate base." A public utility is entitled to earn a return upon all of the cash, materials and supplies, accounts receivable, etc., it actually and reasonably has and uses in the public service, and not merely upon the portion thereof which may have been contributed directly by the investors. Some of the cash may have been borrowed from the banks; some of the alum or coal may have been obtained on credit and not yet paid for; some or most of the cash may have been paid in by the consumers, under the tariff rates. None of these incidents can operate to deny the utility a return upon all of the working capital it actually and reasonably possesses and uses.

Generally the allowance for working capital runs from three to eight per cent. of the value of the total property, which would mean more than $500,000 for working capital in this case.

In the *New York and Richmond Gas Company* case, *supra*, the Special Master had fixed the present value of all of the company's property at $4,750,000, in which he had included $275,000 for working capital—about 5.8 per cent. of the total property. The Special Statutory Court, on December 28, 1925, held this allowance insufficient under the evidence and increased it to $344,144, which was about 6.5 per cent. of the present value of the total property as found by the final decree of the Special Statutory Court.

On a comparable basis, the appellee's allowance for working capital would exceed $1,000,000.

The $19,000,000 minimum figure, as made up by Mr. Hagenah for the purposes of this case, included only $135,000 for cash working capital (R. 86, 88), that being the amount allowed by the Commission in its January order in Case No. 6613.

The appellee challenges anyone to compute and demonstrate any way in which the Commission allowed even as much as $100,000 for working capital, in making the finding and order here complained of. It was the most meager allowance on record, and the appellants' brief is at least consistent in demanding that the appellee be allowed a return on no cash working capital or materials and supplies whatsoever, not even upon the amounts found and inventoried by the appellant Commission's own chief engineer.

(iii) Water rights:

The appellee owns valuable rights on White River and Fall Creek, *viz.*, to dam and restrain the water of the streams, to divert the water through the canal from White River to the filter plant, and to withdraw the water for general use. These rights are property (see *Northside Canal Co., Ltd.* v. *State Board of Equalization,* 8 Fed. [2nd], 739, and cases therein reviewed), and their true and actual value must be included in determining the amount upon which the corporate owner has a right to have its rates such as to yield a fair return (*Los Angeles and Salt Lake R. R. Co.* v. *United States,* 8 Fed. [2nd] 747, 757, and cases cited; *San Joaquin Water Co.* v. *Stanislaus County,* 233 U. S. 454).

These rights were set out in detail in an exhibit prepared by the witness Elmes (R. 195-201). The sum of $500,000 proved by the appellee as the value of these rights was by no means their full worth (R. 72, 95-98, 195-201), but would have been sufficient for the purposes

of this case, if the District Court had in fact allowed this sum shown by the uncontradicted evidence.

There is present in this case no question as to whether or not these water rights of the appellee are used and useful property, to be valued for rate purposes. The law and policy of Indiana have settled that question, and the appellant Commission has so ruled (R. 211, 236). The only question here is as to whether less than $500,000 should have been allowed for these water rights.

The Commission has determined that an allowance should be made for these valuable water rights

In its Order No. 1400, made in 1917, the appellant Commission said, concerning these rights (R. 211):

> "The Company has valuable water rights on both Fall Creek and White River. It is also a large riparian owner. If this city should grow as its citizens hope it will, it does not require a prophet to forecast the time when it will be required to take its water much farther up the stream than Broad Ripple. As the sources of contamination multiply the care and diligence of the Company will be taxed more and more to provide a source of pure and wholesome water for those whom it serves. *Nor is there any denial by anybody in this proceeding that these are water rights that are valuable and should be taken into consideration.* * * * To fix the value of water rights is not more uncertain or indefinite than to fix any other items of value. These rights are not even intangible. *They are real, permanent, and both used and useful.*"

In its order (No. 6613) of January 2, 1923, the appellant Commission said (R. 236):

> "This right is an *extraordinarily valuable part* of the whole value of this property. The right to use the water of White River has saved the Water Com-

> pany and likewise the citizens of Indianapolis millions of dollars over what it would have cost to secure sufficient water for the needs of the city in any other possible way. * * * The Water Company is entitled to share in the benefit of this valuable possession by reason of the fact that by its *foresight, ingenuity and initiative* it has taken this stream of uncertain flow of impure water and has *converted it into an immense asset* both to itself and to the public. * * * Indianapolis is probably the most unfortunately situated of any large city so far as the natural available water is concerned, *yet the possibilities of an insignificant stream flowing through a thickly populated countryside have been so thoroughly developed* that Indianapolis now has, and if it doubles in population, *will have an ample supply of potent (sic., potable) water at a cost much below the cost in many other cities more favorably located.* This development of its water rights, which has been accomplished by the Water Company at times with extreme difficulty, *does actually largely increase the value of the property.*"

Nevertheless, in the face of the above-quoted findings, the appellant Commission permits its solicitor to say to this Court, on page 74 of the appellant's brief, that although "the Commission in Order 7080 allowed something for water rights," "anything it allowed was, however, *a gratuity to the appellee.*" In alleging, in its petition for intervention, that the Commission's knowledge of the facts and the Commission's own decisions would "embarrass and estop" the Commission (R. 39, 40) in making "full defense" to this action in the Courts, the solicitor for the City evidently spoke only in a *legal* sense. No embarrassment or constraint whatever is revealed by the appellants' brief, filed jointly in the name of the City and the Commission.

Extent of the water rights and the statutory basis for them

As part of its property characterized as water rights, appellee includes the right to overflow approximately 1,300 acres of land lying above its dams on White River and Fall Creek. The Commission's engineer allowed a valuation on these rights of $100 per acre. These overflow rights were acquired, either through condemnation or prescription, more than fifty years ago, and if the same rights were to be sought today by condemnation the damages payable by the condemnor would be very substantial—for this item alone, probably more than the company's total claim here for water rights.

These water rights further include, among other things, the right to divert water from White River into the appellee's canal, which extends for more than eight miles before rejoining the stream of White River. A map of the canal (R. 268; fol. 322) shows about twelve miles of White River which is affected by the diversion of the natural flow of the stream into the canal. Without this diversion there would be no adequate supply of water to meet the requirements of the City of Indianapolis. The possibility of a substitute supply is so remote and so expensive as never to have been advocated by any one. If the right to divert the water from White River had not been preserved during all these years by the present company and its predecessors in title, and if an attempt were made today to procure such rights through condemnation, the cost of acquiring the property would be entirely prohibitive.

The excerpts from the appellant Commission's orders, given above, show its keen appreciation, hitherto, of the importance and value of these rights. There is no fairness in, or foundation for, the seeming claim of appellants that the appellee's predecessor, the old Water Works Com-

pany, acquired the canal by gift or in some way as a geographical incident to the ownership of land in the same way that the purchaser of a farm having a brook running through it acquires the brook because he buys the farm. As matter of fact when the State, in 1851, sold the canal in order to be relieved of the burden of carrying it, the Legislature almost concurrently and before the purchase money was paid, passed a separate Act authorizing the purchasers of the canal and their successors in title to operate the canal as a part of a water works system for the City of Indianapolis (Appendix, pages 148 to 150).

The Act of Indiana of 1865 (Appendix, page 151), under which the old Water Works Company was incorporated, invited the City to determine, first, whether it needed water works and, secondly, whether it would supply such works itself or would bring into existence a private corporation to supply the need. The appellant City elected not to supply the water works itself, but to have such a private corporation formed. The appellee and its predecessor, the old Water Works Company, are a result of that election. The City could have purchased the canal and preserved it as a part of its own water works system. It did not do so. The appellee's predecessor did so, in 1869 (Appendix, page 151).

The burden assumed by the original purchasers of the canal property from the State of Indiana, the further burden of proper maintenance of the canal property, its taxes, etc., undoubtedly contributed to the long history of lean earnings of the Indianapolis Water Company's operations. With the splendid growth of the City, the time finally came when it was economically possible, in 1905, to put the canal to all of the water works uses foreshadowed by the Legislature in the Act of 1851. Proper compensation for the Company's expenditure of time and money in preserving

these important rights, now so vitally essential to the industrial and community life of the City of Indianapolis and its environs, should be included in the appellee's rate base; and the company's witnesses were unduly conservative in estimating, for the purposes of this case, a minimum valuation of $500,000 on these actually invaluable water rights.

The only appraisals of the value of the water rights, before the Commission and District Court, were those of Messrs. Hagenah and Elmes. Each fixed that value at the minimum sum of $500,000 and this valuation was naturally undisputed (R. 72; 85, 95-98; 169; 180, fols. 218; 195-201). *Despite the uncontradicted evidence, the $19,000,000 figure adopted by the District Court must have included much less than $500,000 for water rights.*

(5) Depreciation

Virtually no controversial issue, under the decisions, is presented on this subject, by the record here at bar.

The facts

Mr. Elmes, for the company, made a competent, detailed inspection and engineering estimate of all of the *actual* depreciation (R. 93, 94). He found the full extent of the deterioration of any parts of the property from its condition when first installed and placed in practical operation. He then estimated and reported the amount of money which would have to be spent in restoring the property to that condition, as of the appraisal date. That amount he found to total $443,044 (R. 93, 94, 98, 99, 193). He testified that this estimate had been prepared according to "the method I use in reporting to bankers and prospective purchasers of property" (R. 94). Mr. Elmes' report and estimate of

restoration cost was not contradicted, and he deducted its amount from his estimates of replacement cost new (R. 194).

There have been several decisions that such an engineering estimate of cost to restore the property to condition new, measures its depreciation and represents all that needs be deducted from its replacement cost new.

Ottinger v. *New York and Queens Gas Co.*, 1 Fed. (2nd), 351; 268 U. S. 708;
Kings County Lighting Co. v. *Prendergast*, 7 Fed. (2nd) 192, 202, 217; P. U. R. 1925 E, page 5 (Spec. Stat. Ct.); confirming report of Special Master (P. U. R. 1925 C, page 705);
Brooklyn Union Gas Co. v. *Public Service Commission*, 7 Fed. (2nd), 628;
New York and Richmond Gas Co. v. *Prendergast*, 10 Fed. (2nd), 167 (Spec. Stat. Ct.); P. U. R. 1925 E, page 19;
Willcox v. *Consolidated Gas Co.*, 212 U. S. 19.

Some State and Federal Courts have held, on economic grounds, that even the amount of the restoration cost should not be deducted, in ascertaining the present value of a utility property which has suffered no loss of capacity or operating efficiency.

The Bronx Gas and Electric Co. v. *Public Service Commission*, P. U. R. 1923 A, page 255; 28 N. Y. St. Dept. Repts., page 329; affd. 208 App. Div. 780;
Consolidated Gas Co. v. *Newton*, 267 Fed. 231; 258 U. S. 165;
New York and Queens Gas Co. v. *Newton*, 269 Fed. 277; 258 U. S. 165;

New York and Richmond Gas Co. v. *Nixon*, 203 App. Div. 860; 204 App. Div. 838.
See, also, *Nashville, Chattanooga and St. L. Ry. Co.* v. *United States*, 269 Fed. 351; *certiorari* denied, 255 U. S. 569.

That question does not arise here, however, because the appellee admitted that the *actual* depreciation in its property, as ascertained by competent inspection and estimate, should be deducted from reproduction cost new; and from all of such appraisals, deductions were made to reflect the full amount of the actual, existent depreciation (see tables on pages 28 to 30, *ante*).

Mr. Carter, engineer for the Commission, made an actual inspection of all of the appellee's property, and estimated its "percentage condition" by giving effect both to the results of such examination and to the supposed effects of *age*, as disclosed by "life-tables" (R. 130). Mr. Carter found the depreciable property to be in 94 per cent. condition (R. 130); and his "accrued depreciation," giving effect *both* to age and actual deterioration, amounted to $850,000 (R. 130). This sum he deducted from replacement cost new, in reaching present value.

Mr. Hagenah, for the Company, made an estimate of the existent depreciation, based on the results of *actual* inspection of the properties, "with consideration of the probable future life as indicated by the physical conditions noted in the examination" (R. 77). On this basis, he reached conclusions corresponding closely with those of Mr. Carter for the Commission (R. 77-78). On this basis of age and condition, Mr. Hagenah figured the depreciation, as of the time of inquiry, at $1,117,589 (R. 180; fol. 218).

Mr. Bemis, the younger, essayed no embarrassing ex-

amination of the appellee's property. He had no engineering experience and qualification to form a worth-while opinion about it, if he had inspected it. So he made a purely theoretical, hypothetical calculation, on a "straight-line" basis, wholly unrelated to the property itself. This enabled him to suggest that no less than $3,200,000 of the appellee's existent and efficiently-operating property should be denied any return whatever (R. 157, 337).

Mr. Perk, the accountant for the City, likewise made no examination of the properties, but one of the "adjustments" or "decimations" made by him, to reduce further his incomplete record of original cost, was the deduction of $644,749.22 of "depreciation reserve" (R. 317).

Even these extravagant and theoretical deductions proved insufficient for the appellants' brief, so their table (page 86) *doubles* the "depreciation reserve" before deducting it and then *also deducts* $1,878,705 as representing an "additional accrued depreciation allowance" which the appellee *might* have collected (by using young Bemis' fantastic tables) *but never did collect from its consumers.* Because the company did not earn and collect it, the appellants deduct this sum. Had the company collected it, the appellants would evidently have deducted it *twice!*

The law

Under the numerous decisions which have been rendered since this case was tried, it appears that Messrs. Hagenah and Carter were in error in giving effect to "life-table" estimates of age, over and above the actual depreciation shown by competent engineering examination. Only actual, physical depreciation as shown by inspection should *in any event* be deducted from reproduction cost new—"depreciation just as actual as the present value, and the ex-

tent of that depreciation must be ascertained by the same kind of evidence."

Pacific Gas and Electric Co. v. *San Francisco*, 265 U. S. 403;

City of Fort Smith v. *Southwestern Bell Telephone Co.*, 294 Fed. 102; U. S. ; 46 Sup. Ct. Repr. 206; 70 L. Ed. 236; affirmance by this Court on January 25, 1926;

New York Telephone Co. v. *Prendergast*, 300 Fed. 822 [Spec. Stat. Ct.]; S.C. on further hearing: Fed. (2nd) ; decided March 10, 1926;

Nashville, C. & St. L. Ry. Co. v. *United States*, 269 Fed. 351; 255 U. S. 569;

State of Kansas ex rel. Hopkins v. *Southwestern Bell Tel. Co.*, 115 Kan. 236; 223 Pac. 749;

Westinghouse Electric and Manufacturing Co. v. *Denver Tramway Co.*, 3 Fed. (2nd), 285;

Monroe Gas Light and Fuel Co. v. *Michigan Public Utilities Commission*, 292 Fed. 139; ruling reaffirmed on further hearing: Fed. (2nd) ; decided February 27, 1926;

Landon v. *Court of Industrial Relations*, 269 Fed. 433, 445;

Havre de Grace & P. Bridge Co. v. *Towers*, 132 Md. 16; 103 Atl. 319;

Bonbright v. *Geary*, 210 Fed. 44 (Spec. Stat. Ct.);

Standard Oil Co. v. *Southern Pacific Co.*, 268 U. S. 146;

Murray v. *Public Utilities Commission*, 27 Idaho 603; 150 Pac. 47;

City of Winona v. *Wisconsin-Minnesota Light and Power Co.*, 276 Fed. 996;

City of Cincinnati v. *Ohio Public Utilities Commission*, *Ohio* ; 148 N. E. 817;

Southern Bell Telephone Co. v. *Railroad Commission of S. C.*, 5 Fed. (2nd) 77.

Under the above decisions, it is likewise well settled that, contrary to the contentions of the City in this case, the balance in a "depreciation" or "retirement" reserve account should not be deducted, as a measure of the existent depreciation or otherwise.

In the *Pacific Gas and Electric Company* case, *supra*, this Court said, as to the "modified sinking fund" method based on "life tables":

> "Appellant objects to the application of this method, and insists that depreciation should have been ascertained upon full consideration of the definite testimony given by competent experts who examined the structural units, spoke concerning observed conditions, and made estimates therefrom. As these examinations were made *subsequent to the alleged depreciation,* for the definite purpose of ascertaining *existing facts,* we think the criticism is not without merit. Facts shown by reliable evidence were preferable to averages based upon assumed probabilities. *When a plant has been conducted with unusual skill, the owner may justly claim the consequent benefits.*"

Consonant with the above declaration of this Court was the language of the Special Statutory Court for the Southern District of New York in the *New York Telephone Company* case:

> "The legal error (of the Commission) is in not recognizing that the law requires deductions *only for actual depreciation,* just as *actual* as the present value, and the extent of that depreciation must be ascertained by the same kind of evidence; in the last analysis, opinion based on *contemporary investigation.*"

The decision in the City of Fort Smith case

In the *City of Fort Smith* case, as here, the company and the municipality had *admitted* that a deduction should be made from reproduction cost new, for depreciation, to reach the present value of the property. The propriety of such a deduction was not litigated; the contest was as to what should be deducted. The District Court held that only actual depreciation, determined by inspection, need be taken into account in fixing present value, and that inadequacy and obsolescence are the principal causes of property retirements.

The engineering witnesses for the telephone company submitted estimates as to the *actual* deterioration or depreciation, disclosed by competent inspection. The witnesses for the City of Fort Smith claimed there was a further and "hidden" depreciation, due to the *age* of the property. The issue was stated as follows in the brief for the company before this Court (Telephone Company's brief, page 12):

> "the witnesses for the City considered the age, or elapsed life of the property as the basis for making a deduction in *addition* to the actual depreciation. The Company employed the inspection method, the City the theoretical 'age-life' method."

Upon the trial in the District Court, counsel for the City of Fort Smith stated (Record, page 318):

> "Mr. Miles: In order to save time, we are perfectly willing to stipulate that *if you don't take age into consideration* we are willing to agree on their per cent. condition. I want to qualify that to this extent: if the element covering the length of time each piece of property has been in service is not considered, then we are ready to say that their esti-

> mate of it is correct; that our other reduction of it is due to the length of time it has been in service."

The witnesses for the City of Fort Smith then presented testimony that, over and above the actual deterioration, the property had depreciated to the extent of about *ten* per cent. of its value because of the expiration of time since it was first installed. This stipulation and this proof seemed to present the issue very squarely as to the propriety of *a further deduction based on age* or "expired life."

The District Court nevertheless refused to give any effect to the "age-life" method or to any "hidden" depreciation based on *age*. The District Court found and deducted only the *actual* depreciation determined by competent engineering inspection. This Court, on January 25, 1926, did not modify or disturb the result so reached (—— U. S. ——; 46 Sup. Ct. Repr. 206; 70 L. Ed. 236).

The decisions relied upon by the appellants as to depreciation

The two decisions cited and relied upon by the appellants (Brief, page 45) do not support their contentions as to depreciation. The *Kansas City Southern Railway* case (231 U. S. 423, 451) involved technical questions as to the proper accounting treatment of the cost of railroad property retired in order to make way for an improved and shortened road-bed, which would enable more traffic to be handled in the future, at lowered unit costs of operation. This Court said, *inter alia:*

> "Abandonments occasioned by changes of this character are therefore chargeable to future earnings."

In *Nashville, C. and St. L. Ry. Co.* v. *U. S.* (269 Fed.

351; certiorari denied, 255 U. S. 569), before Circuit Judges Knappen, Denison and Donahue, as the Circuit Court of Appeals for the Sixth Circuit, the question was as to the amount which the carrier might deduct, from its gross revenues, for "depreciation" of its property, in computing its earnings taxable under the Corporation Tax Act. The case had been tried before Sanford, *D.J.*, who had sustained the contention of the government that the property of the carrier had sustained no depreciation, beyond that made good in the regular course. The Court was of the opinion that the amounts expended by the railroad for repairs, maintenance, renewals and replacements, fully counteracted the wearing out of parts and the various effects of use, supersessions being made as needed, and that as a result the railway and structures "as a whole" were in fully as good condition and of "fully as great intrinsic value" as they were at the beginning of the years in which the expenditure had been made. This continuing process of repair and supersession was found to have prevented any loss of capacity or efficiency in operation, and so to have maintained the value unimpaired. Judge Sanford had stated it to be his opinion from the evidence that "there is no reasonable deduction for depreciation established."

The Circuit Court of Appeals agreed unanimously with the District Court. The Court said (page 355):

> "To say that property can depreciate without impairment of either intrinsic value or efficiency is to our minds a solecism."

The "chief reliance" of the railroad company in that suit was the claim, advanced here by Dr. Bemis, that over and above, and in spite of, all that is done by way of repairs, maintenance, renewals and replacements, in a composite modern utility or railroad property, there is "inevitable annual depreciation * * * not entirely renewed and replaced" in each year.

This theory was rejected by the distinguished Court. Its opinion said (italics ours):

> "Defendant [the railroad company] did not directly controvert the situation so shown. *Its chief, if not its only, reliance seems to have been on the proposition that, in spite of it all, there was inevitable annual depreciation in some of the perishable elements not entirely renewed or replaced,* so justifying the contention that for this reason there was depreciation within the meaning of the act, even though the roadway as a whole had not decreased in value. *To this argument, as already said, we cannot assent.*"

(i) *The testimony for the appellee and the Commission, and the Trial Court's finding of $19,000,000, were on a conservative basis, as to depreciation.*

Mr. Carter's 1923-24 value figure of $19,500,000 for the appellee's physical property only, was *after* deductions for both the *actual* depreciation and for *age or expired life,* based on the "life-tables" (R. 130, 262, 263).

Mr. Hagenah's depreciation figure (R. 78, 180) was slightly higher than that of the Commission's engineer, and allowed *both* for all the actual depreciation and for "life-table" calculations based on age.

As shown in the tables on pages 28 to 30, *ante,* all of the various estimates of present value were arrived at by making what have now been held to be *excessive* deductions for depreciation. *In any event, there could be no claim that too little was deducted,* on *the facts shown in this record.*

(ii) *The provisions of the Indiana statute do not change the facts or the rules of law, as to the depreciation and present value of the appellee's property.*

If the section of the Indiana Public Service Commission Act (quoted below), relating to depreciation reserve, must

be construed to preclude a return on property purchased out of moneys paid the company in reimbursement of property used up in the service rendered, as contended by appellants (Brief, page 80), then it is in violation of the Federal Constitution. However, the statute clearly should not be construed to mean that all of the property of the appellee may not earn a rate of return calculated upon its present condition and present worth. The inhibition is simply against the capitalization of *moneys* obtained for the purpose of providing for depreciation.

The section referred to (Burns' R. S. 1914; 10052y) reads in part as follows:

> "But in no event shall the moneys expended from the fund for new construction, extensions or additions to the property be credited to or considered a part of the capital account of any public utility, but shall always be charged against the depreciation fund."

In the same section of the statute, it is expressly provided that:

> "The moneys in this fund may be expended for new construction, extensions or additions to the property of such public utility or invested."

It is very evident that if depreciation reserve money shall merely take the place of "used up" property, then when it is reinvested in the property, if capitalized, there would result a constantly increasing capitalization in excess of the actual investment. It was to prevent this possibility that the safeguard of the above section was written into law. There is nothing in the Legislature's treatment of the subject which remotely indicates that such investment in physical property should be denied a rate of return. The statute expressly permits the investment of the deprecia-

tion fund in the property, but expressly inhibits the issuance of stock based on such investment. The appellants do not claim, and the evidence would not warrant a claim if it were made, that any stock was ever issued by the appellee as the representative of reserve fund money reinvested in the property.

(B) The Trial Court's valuation of not less than $19,000,000 did not give dominant, much less exclusive, weight to "spot reproduction" prices of 1923

The appellants have built their brief on their hypothesis that Judge Geiger

> "accepted a spot reproduction of January 1, 1924 (the time of the inquiry), as the *exclusive* measure of fair value" (Brief, page 48).

This assumption appears at many points in the appellants' brief (see, for example, pages 50, 40, 37).

This assumption is wholly unfounded, for many reasons:

(1) The only three estimates of reproduction cost new (depreciated) as of January 1, 1924, before the Court, were as follows:

Mr. Hagenah	$25,404,026
Mr. Elmes	25,357,907
Mr. Carter (including going value, working capital and water rights at the Commission's allowance in Case No. 6613)	21,051,000
Average 1923-24 reproduction cost (less depreciation)	$23,937,644

This does not look as though Judge Geiger's $19,000,000 total gave either exclusive or dominant weight to "spot reproduction" prices as of January 1, 1924. Moreover, as shown in the summary tables on pages 8 to 11, *ante*, the estimates of these three witnesses, based on averaged prices for the ten-year period ended December 31, 1923, themselves averaged $20,935,983 (R. 180, fol. 218; R. 194; R. 132).

(2) Judge Geiger said that although he thought "spot reproduction" for the physical property alone was at least $23,000,000 (R. 63),

> "I am not confronted with the problem of fixing a valuation within the range of dispute upon spot reproduction" (R. 64).

That problem would have confined him within a range of from $21,000,000 to $25,500,000. He fixed $19,000,000 for *all* of the property.

(3) Judge Geiger's clearly expressed views on the valuation of the property of a water company, permit of no inference that he decided this case on any basis of giving exclusive weight to "spot reproduction" prices.

In *Ashland Water Co.* v. *Railroad Commission* (7 Fed. [2nd], 924), Judge Geiger said:

> "We need not at this time consider whether the estimate above placed upon the three decisions is correct. Whether, as suggested in the *Monroe Gas Company* case (D. C.), 292 Fed. 139, present reproduction costs must be *dominantly* reflected in a finding, it would seem that, if the rule of the three cases was worth while promulgating, it contemplated that at least *due* or *substantial consideration* of the evidence of present reproduction costs be reflected in the finding. The rule, if of any value, does not contemplate that Commissions or Courts may play with

percentages in such a manner that—as I propose to show in the present case—the whole situation is not only left to guesswork, but most persuasively suggests an unwillingness clearly to give *substantial, or due, or even reasonable recognition* to the rule" (page 927).

"Now of these Supreme Court cases this may be said: That coming as they did at the end of a decade of enormous advance—of costs—they have been accepted by the bench and bar as enunciating a definite change in the pre-existing *rules for the consideration of evidence* bearing pertinently upon *valuation* of utility properties. They do not pretend to announce (1) that current reproduction costs must be respected as the sole determiner of value; nor (2) that triers of valuation issues have *the right* (which they may exercise or not *at their option*) to take such evidence into consideration. If either such were their purport, then the former would have left the commission here without a defense, and the latter the plaintiff without a case. But what is announced is this: That dominant or controlling—or, in any event, due, or substantial, reasonable, or fair—consideration *must* be given to the evidence of reproduction costs at the time of hearing. Whatever debate may be indulged respecting the adjective to be imported into the rule deducible from the decisions, it seems difficult to escape the conclusion reached in the *Monroe Gas* case (D. C.) 292 Fed. 139, that *dominant* consideration must be given; that such is the 'necessary implication' found in the *results* in those cases. This, however, will be referred to later" (pages 929-930).

(4) The origin of the $19,000,000 figure and the explanation of the way in which it was put together, for the purposes of this case, was with Mr. Hagenah, and he both said and showed that (R. 87):

"In reaching the judgment figure of $19,000,-

> 000, after having before me the reproduction value of $26,500,000, *I do not give major weight to the present levels.*"

Mr. Hagenah tried to formulate a figure which would be below any possibility of fair challenge. How drastically he took virtually everything against the company is shown by his explanation (R. 87):

> "I have before me the appraisal of this property on seven different price levels. In reaching the judgment figure of $19,000,000, after having the reproduction value of $26,500,000, I do not give major weight to the present levels. In the first place I take off existing depreciation from all my appraisals, which is about $1,500,000. I first find the physical property alone. My appraisals of this property as of this date ranged from $17,052,000 for the *physical property alone,* based on one price level, to $22,682,000 on another price level. For the reasons that I have already stated, my concession to the original cost of the property and arriving at my fair value figures *I reject in such compromise the high price levels* because they are not permanent. The lowest price level—the ten-year level, in which high and low price levels are taken into consideration and weighted—is $17,052,000. *That is the lowest possible figure I could get without going back to the pre-war days.* But even in that figure I go from 1911 to 1920. I think I should add something to that *because of changed conditions since 1920,* and I increase that figure to $17,500,000 by adding $448,000 as my concession to all the economic conditions affecting labor prices, interest and taxes that have transp ed since the end of 1920. *That gives me $17,500,000, which is the minimum value of the physical property alone and is as low as it is because of concession to the original cost or actual investment.* I further add $1,416,000 allowed by the Commission for going concern value and water rights. In round numbers after adding these three items I get $19,000,000" (R. 87-88).

It was upon such a range of testimony as the preceding pages have outlined that the District Judge was compelled to exercise an independent judgment as to whether a valuation of $15,260,400 had given *sufficient* consideration to reproduction cost at present-day prices. It cannot be said that a $19,000,000 figure gave *exclusive* weight "to spot reproduction" prices as of January 1, 1924.

We invite anyone to take the *undisputed* testimony for land at market value, structural property at prices which give any weight to 1923-24 costs, undistributed structural costs at 15 per cent., going value, water rights, and working capital, and add them up on any rational basis to produce a total valuation lower than $19,000,000.

(C) Judge Geiger need not have limited the appellee to the minimum figure of $19,000,000.

The conservative character of Judge Geiger's determination is further emphasized that although he felt that the appellee's physical property alone, at 1923-1924 prices, amounted to $23,000,000 (R. 63), he felt constrained to limit his valuation to the $19,000,000 *minimum* figure which the present appellee had offered to accept as "a fair basis" for the present determination (R. 64).

His action in this respect may fairly be contrasted with that of Denison, *C.J.*, and Tuttle and Simons, *D.JJ.*, in the Special Statutory Court for the Michigan District, in the *Monroe Gas Light Company* case, on February 27, 1926. In the latter case, the Company's bill of complaint had alleged a value of "$400,000 *and upwards*" (here the allegation is "not less than" $19,000,000). The Special Statutory Court found that, on a conservative basis, the value of the gas company's property was $425,000, and so allowed this amount, saying:

> "We do not overlook that the amended bill alleges a fair value of '$400,000 and upwards.' Under some circumstances, it would be right to hold the plaintiff to that definite figure as a maximum; but to do so now would only lead to a request for an amendment which we should grant. We should grant it because, upon plaintiff's theories, more than $400,000 was immaterial and hence sufficiently alleged by 'upwards.'"

In contrast, Judge Geiger limited the present appellee to its figure of "not less than $19,000,000" (R. 54).

II

THE TRIAL COURT WAS FULLY WARRANTED IN REFUSING TO FOLLOW THE METHODS BY WHICH COUNSEL FOR THE APPELLANTS SEEK TO COMPUTE A PRESENT VALUE OF LESS THAN $19,000,000.

Confronted with the proofs which we have reviewed, indicating a present value of at least $23,000,000 for the appellee's useful property, counsel for the City and the Commission endeavored, in the Court below, to cut and slash this sum, by devious expedients urged by the Messrs. Bemis, so as to furnish some pretext of support for the Commission's figure of $15,260,400. In this Court, these same contentions are renewed in behalf of the appellants, and are summarized at pages 86 and 87 of their brief, in connection with Mr. Hagenah's estimate of 1923-24 reproduction value.

We shall proceed to discuss *seriatim* these deductions and eliminations, by way of demonstrating that they were so unsound and fallacious that the District Court was fully justified in refusing to accept and follow them. In fact,

the minimum figure of $19,000,000 may be regarded as having given to them really more weight than was warranted.

(1) Deduction of so-called "excess overheads" (undistributed costs)

Although the appellee's witnesses, the Commission's engineer, and the Commission's own prior determination (R. 229), *agreed* that *fifteen* per cent. was a reasonable allowance for undistributed structural costs, and although the decisions and the testimony, as reviewed on pages 31 to 35, *ante*, show that 15 per cent. was a minimum and most conservative figure, the appellants had the temerity to demand the elimination of $2,462,497 from Mr. Hagenah's appraisal, representing 12.4 per cent. out of the moderate 15 per cent.

The *undisputed* testimony is sought to be ignored or evaded, because the appellants claim that the 15 per cent. allowed by these witnesses does not appear to have been actually expended by the company and charged to "overhead" accounts.

As to this claim, it must be said:

(a) *It is based on false assumptions of fact.*

It is true that Mr. Perk in his study (which arbitrarily omitted the first eleven years of the property's history) found only 5.8 per cent. expended for overheads and charged to accounts which he recognized as such; therefore he argued that no more should be allowed as the present value of these items. (Appellants' brief, pages 22, 81). Mr. Hagenah's testimony is uncontradicted that since the *beginning* of the enterprise, the books show 9¾ per cent. for overheads, but the books did not capitalize taxes or interest

during construction, which would amount to at least 6 per cent. more (R. 80). We think that members of this Court will recognize that if the cost to the company of these elements is shown by the books to have been as much as 9¾ per cent. of the property, their present replacement cost will exceed 15 per cent.

(b) *It is based on false assumptions of law.*

Appellants' first error is in confusing the present value of these elements of property with their original cost and with the accounting treatment of that cost. In the *Ohio Utilities Company* case this Court said:

> "*Reproduction value, however, is not a matter of outlay, but of estimate,* and should include a reasonable allowance for organization and other overhead charges that necessarily would be incurred in reproducing the utility. In estimating what reasonably would be required for such purposes, proof of actual expenditures originally made, while it would be helpful, is not indispensable."

To the same effect is the following ruling of the Special Statutory Court in *Monroe Gas Light and Fuel Co.* v. *Michigan Public Utilities Commission* (292 Fed. 139):

> "Such overheads as were involved, viz., interest and taxes during construction, contractor's profits, and items which all the witnesses classify as 'undistributed costs,' are as much a part of the fair value of the plant, considered on any basis, as are the iron and the bricks. The only evidence before the Commission was the report of its own engineers, who, both as to reproduction cost and original cost, made this estimate of about 14 per cent. The only additional evidence before the court is that of the utility's engineers, who testify that the proper allowance is about 20 per cent. * * * Obviously these overhead costs would not appear

'upon any records of the plaintiff or anybody else.' There was no reason why they should. The utility's books did not purport to go back and show total actual disbursements for construction. The engineers arrived at their prudent investment cost by computing what labor and material should have cost at the respective dates involved, and there was nothing to indicate that they made the mistake of counting these overheads in again after they had originally estimated for the same things. Therefore we conclude that, at least, that estimate of overheads made by the Commission's engineers must be accepted in arriving at the rate base."

See, also,

Bonbright v. *Geary,* 210 Fed. 44 (Spec. Stat. Ct.);

Boise Artesian Water Co. v. *Public Utilities Commission of Idaho,* 40 Idaho 690; 236 Pac. 525;

New York and Richmond Gas Co. v. *Prendergast,* 10 Fed. (2nd) 167.

The testimony of Mr. Hagenah, as well as that of Mr. Elmes and Mr. Carter, showed that at least the amount allowed by each of them for undistributed structural costs would actually and reasonably be required in replacing the property as of 1923 or today (R. 72, 81, 93).

Appellants' further error of law is the idea that, because some of these costs as actually incurred were paid for as an operating expense, therefore they should not be considered in ascertaining present value. The Courts have repeatedly held that the *value* of a property is not affected by any consideration of the source from which the owner got the money to pay for it. See cases cited on page 48, *ante,* and page 79, *post.*

In connection with appellants' argument (Brief, pages 67-69) that because appellee's books "show no charges to capital for taxes or interest (during construction) and do show every cent expended," therefore no such expenses could have been incurred, it is only necessary to point out that such expenses might well have been included in the $10,050,271 of operating expenses from 1881 to 1923. Appellants refer to no evidence, and there is no evidence in the record, showing that this sum of $10,050,271 did not include actual payments for taxes and interest during construction.

Although the appellants do not show it as a *separate* deduction in the table on pages 86 and 87 of their brief, their argument criticizes Mr. Hagenah's allowance of ten per cent. for contractor's compensation and profit. The grounds of their criticism of this customary inclusion is the absence of accounting record of any such outlays by the appellee, in the piecemeal construction of its property. An allowance for this item has been made and upheld in virtually all of the cases hereinbefore cited, and Mr. Hagenah's testimony concretely supports it in the present record (R. 83). At page 45 of their brief, appellants cite *Nashville, Chattanooga and St. L. Ry. Co.* v. *United States* (255 U. S. 569), as authority for the denial of contractors' profits, as a part of reproduction cost appraisals. The citation is to the denial by this Court, without opinion, of a petition for certiorari; no such ruling is revealed.

(2) Deduction of $1,167,018 on the theory that $583,509 of the appellee's property had been "paid for through operating expenses."

The appellants' theory on this item (Brief, page 86) is essentially that $583,509 of net earnings of the appellee, under rates limited by Commission order or by contract

with the City, were not distributed to stockholders but were invested in useful property. To punish any such prudent policy as they think it deserves, the appellants demand that a return be denied the appellee upon any of this property. To make the deduction larger, the appellants assume that all of the property purchased with undistributed earnings has appreciated in value at least 100 per cent. This enables them to double the sum before deducting it.

Such a proposal proceeds from an unsound view of the status of private property under public regulation. It makes present *value* a matter of original outlay rather than present worth, and seeks to confuse and control both inventory and value with the concepts of cost accounting.

The appellee is engaged in *selling water service.* It is not performing a public function on a *"cost plus"* basis. The company sells its service for a fixed rate regulated by the State since 1917 and by contracts with the City prior thereto. The entire revenue produced by the rates thus limited was paid to the company for the service received; it became the property of the company, just as the service became the property of the consumers.

The prior rates and the earnings under them are presumed to have yielded neither more nor less than a fair return. The company cannot now claim that rates *in which it acquiesced* were too low and that its resultant losses should be made good. The State and City cannot claim that the rates which they fixed or permitted yielded more than a fair return, or that the net earnings do not belong unqualifiedly to the company, to be distributed to shareholders, invested in new property, or segregated in prudent reserves, as the directors see fit. The appellee may not be penalized now for its lawful operations of the past, as would be the result if it were denied a return upon property purchased with undistributed proceeds of its rates.

Newton v. *Consolidated Gas Co.*, 258 U. S. 165, 175;

Municipal Gas C[illegible]y of Albany v. *Public Service Comm[illegible]* N. Y. 89, 99 (Cardozo, *J.*);

Boise Artesian Water Co. v. *Public Utilities Commission*, 40 Idaho 690; 236 Pac. 525;

City of Cincinnati v. *Ohio Public Utilities Commission*, —— Ohio ——; 148 N. E. 817;

City of Erie v. *Public Service Commission*, 278 Pa. St. 512; 123 Atl. 471;

Okmulgee Gas Co. v. *Corporation Commission*, 95 Okla. 213; 220 Pac. 33;

Garden City v. *Garden City Telephone Co.*, 236 Fed. 693;

Western Oklahoma Gas and Fuel Co. v. *State*, 239 Pac. 588;

Monroe Gas Light and F. Co. v. *Michigan Public Utilities Comn.*, 292 Fed. 139;

Brooklyn Union Gas Co. v. *Nixon*, 2 Fed. (2nd) 118;

Galveston Electric Co. v. *Galveston*, 258 U. S. 388;

New York Telephone Co. v. *Board of Utility Comrs. of New Jersey*, 5 Fed. (2nd) 245.

The rule of the first two cases above cited has been specifically cited, quoted and adopted, as controlling upon the appellant Commission and upon all creatures of the State of Indiana, by the highest Court of that State.

Columbus Gas Light Co. v. *Public Service Commission*, 193 Ind. 399, 403; 140 N. E. 538.

(3) Deduction of $1,289,498, from Mr. Hagenah's 1923 replacement value of $25,404,026, on the ground that $1,289,498 of such sum represented "property purchased with depreciation reserve money ($644,749) appreciated in appraisal over 100 per cent."

The amount of any unexpended balance in retirement or depreciation reserve should not be deducted from either the inventory or the appraisal of the property actually owned and used.

See cases cited on pages 58 to 62, *ante;* and also:

Michigan Public Utilities Commission v. *Michigan State Telephone Co.,* 228 Mich. 658; 200 N. W. 749;

New York Telephone Co. v. *Board of Utility Comrs. of N. J.,* 5 Fed. (2nd) 245;

City of Charleston v. *Public Service Commission,* 95 W. Va. 91;

Pennsylvania Gas Co. v. *Public Service Commission,* 204 App. Div. (N. Y.) 73;

Bonbright v. *Geary,* 210 Fed. 44 (Special Stat. Ct.).

Under any arguable theory, the appellee is constitutionally entitled to earn an adequate return upon *all* of its inventoried property, and the amount of the *actual* property owned and used by the appellee is subject to no deduction or diminution on any theory as to the source of the funds with which the appellee paid for any part of the property.

Moreover, the appellants' contention represents a muddled failure to distinguish between *funds* and *accounts.* Property is not purchased with *reserves;* the appellants

merely *assume* now that *physical property which has appreciated over one hundred per cent. since purchase,* was bought *with the reserve.* Of such an assumption there is and could be no proof.

It may be noted that the appellants realize, however, that even the deduction of the full "depreciation reserve" ($644,749) would not be sufficient for their present purposes. So they appreciate it one hundred per cent. (Brief, page 86) *and deduct it thus doubled!*

Furthermore, it should be kept in mind that, as shown on pages 57 to 59, *ante,* Mr. Hagenah deducted practically $1,100,000 for depreciation, based on inspection and taking account of age (R. 180; fol. 218); Mr. Carter deducted $850,000, on the same basis (R. 262, 263); and Mr. Elmes deducted $443,044, for the full amount of the actual observable depreciation (R. 194). If, in addition to these deductions for all of the actual depreciation, the amount in the "depreciation reserve" should be doubled in amount and then deducted, there would be accomplished the *triple* deduction which the appellants seek and need!

(4) Deduction of $1,232,913 from Mr. Hagenah's appraisal, for the replacement cost of the canal (exclusive of the land but with 15 per cent. eliminated for contractor's expense and profit).

The appellants strongly urge that $1,232,913 should be deducted from Mr. Hagenah's valuation, because of the canal (Brief, page 86). This they propose on grounds which, on analysis, may be summarized as follows (Brief, page 72):

> (i) That its construction was paid for by the State of Indiana, and that therefore the appellee should not be allowed to earn a return upon the value

of any of this property, even though it is now lawfully owned by the appellee, which gave value for it;

(ii) That it would not be built today, if the appellee's property were being reconstructed or a substitute system were being built; and

(iii) If the property were being constructed or reproduced today, and this canal property were needed for the water business, it would be acquired by the appellee by eminent domain and would not be built by it.

Any argument based on the fact that part of the canal property was originally built and first paid for by the State is answered by the decision of this Court in *San Joaquin, etc., Co.* v. *Stanislaus County* (233 U. S. 454, at 459), and like cases. That it was not originally constructed by this company places it in no different category from the roadbed of a railroad, which was constructed by independent contractors instead of the railroad company which afterwards acquired and used it as a part of its public utility. The property is now owned and used by the appellee, in rendering a public service in which the canal plays a useful and important part.

There is no evidence in this record to support the bald assertion that the canal "would not be constructed in reconstructing the utility." The appellant Commission must be *both embarrassed and estopped,* in having such a contention made in its name. The Commission is definitely committed to the fact that this "canal appears to have been *perfectly* adapted to become a part of the water plant of the City," and that "it has never failed to do *effectively* the work that must be done by some instrumentality of the water plant," and that any such instrumentality "*would*

exceed the cost of reconstruction of the canal and its structural parts" (R. 210). The Commission has determined these things by order, and the municipal intervenor may not review those orders here. Moreover, the State of Indiana, in 1851, by legislative enactment (see Appendix, pages 148 to 150), authorized the use of the canal for waterworks purposes for Indianapolis; and the municipality, as the creature of the State, cannot challenge or review here that action.

The younger Bemis, in the role of "appraisal engineer" for the City, advanced the suggestion which has been rejected alike by the appellant Commission and by the District Court. His inexperience suggested to him that a substantial portion of the canal value should be eliminated because the portion of the canal below the filtration plant is used only for hydraulic and certain rental purposes, and that the *abandonment* of this part of the canal and the *substitution of a steam plant* would effect a reduction in operating expenses which, if capitalized at seven per cent., would reduce the rate base $785,000 (R. 158, 336).

As elsewhere pointed out, this witness received a degree in mechanical engineering from the University of Wisconsin in 1915 and since that time has been employed only as an *appraisal* engineer and only by his father, Professor E. W. Bemis. His experience shows no qualification in the construction, operation or management of a water works, which would give any weight to his opinion on the practical question of this suggested abandonment and substitution (R. 156).

The fact that if the appellee did not have the canal to serve the purposes which it does in bringing the water to the municipal area, equalizing the flow, and furnishing storage and preserving pressure, the appellee would

have to construct a more costly substitute, meant nothing to young Mr. Bemis.

No one testified that, in continuing to own and use the lower portion of the canal, the company is not exercising good business judgment *in the economic management of the property as a whole.* On the contrary, as against the opinion of the younger Bemis, who claims no practical experience as a water works engineer, must be considered the canal and its use as described by the Commission in its order fixing the rates here under review (R. 15):

> "By means of an open canal the water is taken from the river at Broad Ripple and transported by gravity to the filter beds and then a part of it goes to the pumping station at Riverside, and then to the hydraulic station at West Washington Street to be forced into the mains, and the water not taken from the canal to the filter beds furnishes the water power to operate the turbine pumping water into the mains at said hydraulic station. *This shows the work of a competent construction engineer*" (R. 15).

As still further bearing upon the practical question of the usefulness of the *entire* canal in the economical rendition of this public service, is the language of the appellant Commission in an earlier order (R. 210):

> "*The canal appears to have been perfectly adapted to become a part of the water plant of the City.* It intercepts the waters of White River near Broad Ripple. This is so far up stream that the source of supply has been free from contamination arising from densely settled districts of the City for nearly half a century. This has been done so successfully that there is not, in the long record of this proceeding, a word of evidence touching the impurity of the water or the insufficiency of the supply. It saves the lift of millions of gallons of water daily

> from White River to the level of the filter beds. * * * *The economic value of the canal is very large when regard is given to the savings it effects and the revenue it produces.* Yet its economic value is not represented by such savings and such revenues. Its great value lies in the fact *it has never failed to do effectually the work that must be done by some instrumentality of the water plant.* The cost of a steel or concrete main or conduit, that would carry a far less quantity of water, would exceed the cost of reconstruction of the canal and its structural parts. *The entire canal is used and useful* in the performance of the service this utility was created to perform" (R. 210).

In the face of these determinations by the appellant Commission, how may contrary contentions be urged here, by that appellant or by an intervenor which has not reviewed these determinations in the State forum?

The fact is, of course, that this perhaps casual suggestion by the young Mr. Bemis, and certain minor substitutions suggested by Mr. Carter, were improper and not germane to the question before the Court, *viz.*, the present value of the property actually owned and used in the rendition of the service. If Commissions are to base rates on the value of supposed substitute plants, or parts of plants, they must enter the field of management and substitute their business judgment for that of the owners.

In the case of *Kennebec Water District* v. *City of Waterville* (97 Me. 185; 54 Atl. 6), it was held by the Court that the line of inquiry must be limited to the replacing of the present system or one substantially like it, and that it is the present value of the existing plant which is to be determined and not the value of some hypothetical or imaginary plant. The Court said:

> "To enter upon a comparison of the merits of different systems—to compare this one with more modern systems—would be to open a wide line to speculative inquiry, and lead to discussions not germane to the subject. It is this system that is to be appraised in its present condition and with its present efficiency."

In *Brooklyn Union Gas Company* v. *Prendergast* (7 Fed. [2nd] 628, at page 670), the Court said:

> "What we are to find is the fair value of the property which the plaintiff was dedicating to the public service, and not the value of what the defendants may have considered an efficient substitute."

See, also,

Capital City Gas Light Co. v. *Des Moines*, 72 Fed. 829;

National Water Works Co. v. *Kansas City*, 62 Fed. 853;

Consolidated Gas Co. v. *Newton*, 267 Fed. 231, 261, 263, 267-8; 258 U. S. 165;

New York and Richmond Gas Co. v. *Prendergast*, 10 Fed. (2nd) 167; P. U. R. 1925E, page 19.

The last reason assigned by appellants for eliminating the cost of reproducing the canal is that instead of such cost, the price paid as the result of eminent domain proceedings should be substituted. That is simply arguing in a circle, as in eminent domain proceedings, the *present value* of the canal would be ascertained by evidence of reproduction cost. This is so held in the very case of *United States* v. *Boston, etc., Canal Co.* (271 Fed. 877, 889), cited by appellants.

(5) Deduction of $1,878,705 for "additional accrued depreciation allowance" not claimed to have been collected from the appellee's consumers.

One of the most indefensible deductions proposed is that outlined on pages 85 and 86 of the appellants' brief. Mr. Elmes' estimate of the "depreciation" was $443,044, as discussed on pages 57 to 59, *ante*. Mr. Hagenah's figure, giving effect to all possible bases, was $1,117,589 (R. 180; fol. 218). These were competent engineering estimates based on actual knowledge and careful inspection.

Without knowing anything about the appellee's property or being competent to form any judgment about it, Walter S. Bemis theoretically estimated the "accrued depreciation" at $2,996,293.97 (Appellants' brief, page 86).

Because they could not find that the appellee had ever collected from its patrons as much money as that, to make good this theoretical non-existent "depreciation," the Bemis's propose to deduct from the Hagenah appraisal $1,878,705 which the appellee did not collect for this useless purpose. Because the appellee failed to collect $1,878,705 more, the Messrs. Bemis generously seek to deduct this amount from present value.

(6) Deduction of $500,000 for "non-operative" property, "over Mr. Hagenah's allowance."

The appellants' brief (page 87) suggests no adequate reasons why this Court should review and disturb the conclusions of the District Court in this respect. Neither the Court nor the Commission excluded the property in question.

Mr. Carter, engineer for the Commission, showed in his Exhibits Nos. 34 and 36 (R. 262 and 263) the sum of $648,-

921 for what he labelled "*non-operative* property." Of this sum, portions of the appellee's well-land areas amounted to $342,740 (first five items on page 266 of the record, plus Mr. Carter's allowance of 15 per cent. for undistributed costs), leaving $306,181 for miscellaneous properties other than the well-lands (R. 265).

Neither Mr. Carter nor any other witness for the present appellants undertook to demonstrate and justify the exclusion of these properties as *not used and useful*, even though some of them were not actually *operating*. Mr. Metcalf showed that not more than $68,000 of the appellee's property could be considered non-useful in its water business (R. 123). Mr. Hagenah put the total of *non-operative property* at $111,242 (R. 171). Neither Mr. Metcalf nor Mr. Hagenah included any of the well lands in their list of properties not used in active operations. Neither of them undertook to exclude or deduct any of the properties from the "rate base." Their continuance therein was deemed justified on the grounds (1) that such properties were being reasonably held for prospective needs and uses of the company; and (2) that they were closely integrated with properties which were being actually and actively operated by the appellee, so that the fairest thing to do with them was to place them in the "rate base" and include in operating revenues the rentals received by the appellee therefrom.

The determination of the usefulness of property always involves the exercise of an informed judgment based on practical experience in the operation of the kind of utility in question. The owner as manager may exercise its business judgment as to the kind and amount of property necessary. No Commission is authorized to substitute its judgment in such a matter unless the evidence clearly shows that there has been an *abuse* of the discretion lodged in the owners.

State of Missouri ex rel. Southwestern Bell Tel. Co. v. *Public Service Commission*, 262 U. S. 276, 289;

State Public Utilities Commission v. *Springfield Gas and Electric Company*, 291 Ill. 209, 232, 234;

Consolidated Gas Co. v. *Newton*, 267 Fed. 231; affd. 258 U. S. 165.

Columbus Gas Light Co. v. *Public Service Commission of Indiana*, 193 Ind. 399; 140 N. E. 538.

(i) *The District Court ruled against the elimination of the appellee's well-lands* (R. 127, 166) *and was clearly right in so doing.* Mr. Carter at no time testified that in his opinion such well-lands were not reasonably necessary to the service furnished the public. He presented an appraisal in which certain well-lands were listed as *non-operative* (R. 126, 131, 262). On this subject, however, Mr. Metcalf, the distinguished consulting engineer for the company since 1907, testified that there are forty-three active wells on lands totalling 240 acres; that a considerable number had been driven in the last fifteen or twenty years; that well water is the cheapest water produced by the company; that the well supply economically contributes to the "peak" or "fire" load; that a further number of wells ought now or soon to be driven; that the area of the well-lands now owned is reasonably needed for the protection of the quality of water and for future supply; that the acreage of clear land around the wells is not out of proportion to engineering practice in other communities; that it would be unwise and improvident to try to cut and carve out from among the existing wells some fragments of land not directly occupied with wells and appurtenances; and that, if not left in the "rate base" but if sold by the company, it would be impossible to reassemble

these necessary lands (R. 122, 123). Under these circumstances and the cases cited on pages 85, 86, and 89, *ante*, the District Court properly refused to set aside the judgment of this company in retaining the area of these present and future wells.

(ii) The remaining $306,181 of miscellaneous property listed by Mr. Carter as non-operative (R. 265) was not dealt with, by him or by anyone else, in testimony justifying its deduction. Mr. Metcalf showed that the non-operative property did not exceed $68,000 (R. 123), and that even this amount should not be deducted as improvidently held. For reasons already indicated on page 88 *et seq.*, *ante*, this property should remain in the "rate base" and the rentals therefrom should remain in the operating revenues.

(iii) Mr. Carter also presented an exhibit which showed illustratively the difference between the company's well-located office building and the supposed cost of a substituted office on land in a less desirable location (R. 126-127, 268, 269). No one testified that in maintaining the office building on the present site, the company was not exercising good business judgment, and the Commission did not itself hold this property non-useful. As to this attempt to eliminate the value of the office building and land, the District Court at the hearing said: "Unless the holding can be said to be merely colorable, I think it rather a serious thing to reconstruct an office site" (R. 127).

(7) Deduction for the additional cost of laying mains in congested areas.

The appellants propose now to deduct $415,000 from Mr. Hagenah's present replacement figure of $25,404,026, because of what they see fit to term a "*theoretical* allowance for *extra* cost of laying mains" (Appellants' Brief, page 87). The item represents nothing of the sort; it repre-

sents an *inescapable* part of the actual cost of main-laying; and there is no possible basis for its deduction.

Mr. Hagenah's unit prices were based on average conditions in the *non-congested* areas (R. 83). In the highly congested parts of a City such as Indianapolis, there is an *additional* cost, due to the sub-surface and traffic conditions, but Mr. Hagenah did not include in his unit prices this extra cost "for an extraordinary condition" (R. 83).

This is in no sense a *"theoretical"* cost, such as the putative cost of cutting and restoring paving over mains in streets not paved when the mains were laid (*Des Moines Gas* case, *supra*). *It is the uncontradicted estimate of a competent witness as to the actual additional cost of laying mains in the congested areas, and so has to be added to the cost of main construction in the non-congested districts.*

(8) Elimination of all allowance for going value and water rights.

In their frantic desire to reduce the present value of the appellee's property to a figure on which the Commission's rates might approach a fair return, the appellants propose (Brief, page 87) to cut out of Mr. Hagenah's 1923 reproductive valuation *all allowance for going value and water rights.*

The elimination thus proposed would be $2,500,000, although the Commission allowed only $980,000 for going value, water rights, and working capital, which Mr. Hagenah had appraised at a total of $2,735,000.

The propriety of an allowance, very much in excess of $980,000, for the appellee's going value and water rights, was discussed on pages 35 to 57, *ante*. To eliminate these items altogether would be flagrantly contrary to the law and the facts.

(9) Deduction of all working capital

Without rhyme or reason, the appellants' brief proposes (page 87) to diminish the Hagenah appraisal by striking out completely the $235,000 item, which is erroneously stated to represent only the "working cash capital" but actually includes as well the materials and supplies (R. 72).

There is no citation of authority denying the appellee a right to earn a return upon its working capital, and no showing as to how the appellee could get along and carry on its business without cash working capital.

The law and the facts as to the appellee's working capital were discussed on pages 48 to 52, *ante*.

(10) Deduction for an "adjustment" suggested by the younger Bemis as to cast-iron pipe prices.

No less than $1,046,504 is proposed to be deducted from Mr. Hagenah's present replacement value, because of another ingenuous "adjustment" proposed by the younger Bemis (Brief, page 87).

This presents a characteristic instance of confused thinking, an utter failure to distinguish between original cost and present replacement cost. The younger Bemis was not criticizing, in his testimony as to this item, Mr. Hagenah's appraisal or any of Mr. Carter's estimates of replacement cost at any post-war price level (R. 157). He was dealing with Mr. Carter's estimate of cost on the basis of the averaged actual costs for the ten-year period of 1911 through 1920, which had ended more than three years before the proceedings in the District Court. Mr. Bemis suggested that inasmuch as the company had not actually purchased its pipe in *equal monthly installments,* Mr. Carter's average of the actual market prices for the ten-year period did

not give an accurate actual cost figure for that period (R. 157). He purported to find an error of $523,252.

Such a criticism has no logical or tenable relation to a valuation reached by applying 1923 unit prices to a 1923 inventory. Nevertheless, the appellants' brief takes young Bemis' computation of what he deemed to be Mr. Carter's error in computing actual cost from 1911 to 1920, *multiplies it by two,* and then deducts the $1,046,504. from Mr. Hagenah's replacement cost in 1923!

III

THE TRIAL COURT WAS FULLY JUSTIFIED IN CONCLUDING THAT THE TESTIMONY OF THE COMMISSION'S OWN CHIEF ENGINEER (MR. CARTER), IN CONJUNCTION WITH THE OTHER APPRAISALS, WARRANTED A VALUATION OF NOT LESS THAN $19,000,000.

The learned District Judge heard and observed the witnesses—the Commission's chief engineer, Messrs. Hagenah, Elmes and Metcalf, and Professor Bemis and son. He heard exhaustive argument of counsel, and considered extensive briefs. His valuation of not less than $19,000,000 was "upon mature deliberation" (R. 56).

The rule that where the judgment of the Trial Court is based upon evidence that clearly preponderates in favor of the conclusion reached, it will be affirmed by this Court, is applicable to rate and valuation litigation.

> *Houston* v. *Southwestern Bell Tel. Co.,* 259 U. S. 318, 321.
>
> *Nashville, C. and St. L. Ry. Co.* v. *United States,* 269 Fed. 351; certiorari denied 255 U. S. 569).

We have shown, on pages 11, 29, and 30, *ante*, that the estimates presented before Judge Geiger by Mr. Carter, the engineer for the Commission, enabled the following conclusions, as *minima:*

(1) That the physical property only (less depreciation), at 1923-24 wages and prices, as estimated by Mr. Carter, was at least .. $19,500,000[1]

(2) That such physical property as estimated by Mr. Carter, plus even the Commission's own January allowance for going value, cash working capital, and water rights, was at least ..... 21,051,000[1]

(3) That even on the basis of wages and prices averaged by Mr. Carter for the ten-year period ended December 31, 1923, plus the Commission's January allowance for going value, cash working capital and water rights, was at least ..... 18,557,370[2]

On the basis of this testimony, tantamount to *admissions* by the competent engineering representative of the Commission, Judge Geiger seems to us to have been abundantly justified in finding a minimum value of at least $19,000,000. The appellants, however, seek to "impeach" and "discredit" the Commission's engineer, by urging a series of eliminations and deductions, which are summarized on pages 80 to 84 of their brief.

Anomalous position of the appellants in this Court

Before taking up and discussing further, under Point IV, *post*, each of these proposed eliminations and deduc-

[1] As shown on page 30, *ante*, this figure includes land at substantially less than the market value proved by uncontradicted testimony.

[2] As shown on page 29, *ante*, Mr. Carter's so-called ten-year average did not include or use, in his averages, the prices for 1917 or 1920. Use of the actual ten-year averages, or the addition of going value, working capital and water rights at the lowest figures shown by the opinion testimony, would bring this figure to a sum substantially higher than $19,000,000.

tions, we wish to refer to the anomalous and untenable position in which both the appellants place themselves by their demands now under discussion. The appellant Commission has made findings and an order, in a proceeding in which the appellant City intervened as a party. The appellant City has not reviewed, in the State Courts, the findings and order of the appellant Commission (see pages 15 to 18, *ante*).

The appellant Commission's own engineer presented to it, under oath, carefully prepared inventories and appraisals, which included practically all of the items which the appellants say now should be excluded. Virtually all of the contentions now made as to the properties were urged by the City before the Commission, and had been urged before, but the Commission's competent engineer found no merit in these contentions and did not sustain them in his inventory or his valuation.

Moreover, the appellant Commission took the trouble to discuss specifically, and to justify and approve, various of these items (see, for example, R. 17, 19, 229, 236), whose exclusion is now demanded in the ostensible joint brief of the Commission and the City.

Furthermore, the appellant Commission presented its engineer, Mr. Carter, to the District Court, as a *credible, reliable and competent* witness. It introduced his various appraisals in evidence; and in so doing, the Commission made no effort to repudiate, discredit, disavow, or even disagree with, the appraisals of its engineer or with any of the items included therein. Nevertheless, the appellants' solicitors, in their brief on this appeal, attack Mr. Carter bitterly and devote most of their brief to an attempt to discredit him and to repudiate various of the substantial items which he sustained both from his knowledge of the property and from his experience and informed judgment.

We have here the astounding spectacle of the appellant Commission's blandly saying to this Court that the testimony of its own engineer, which the Commission adopted

literally in Case No. 6613 in January of 1923, relied upon largely in Case No. 7080 in November, and sponsored before the District Court throughout 1924, must be regarded here as "*self-impeached*" (Appellants' brief, page 63).

IV

THE TRIAL COURT WAS FULLY JUSTIFIED IN REFUSING TO ACCEPT, OR TO ATTACH IMPORTANCE TO, THE CITY'S SO-CALLED "REPRODUCTION COST APPRAISAL."

On pages 20 and 21 of the appellants' brief, is the appellants' own description of the *alternative* offered to Judge Geiger, which he was urged to accept and follow, instead of the appraisals of Messrs. Hagenah, Elmes and Carter. We think Judge Geiger was abundantly warranted in rejecting a computation so unsound.

This computation was put in evidence by the younger Bemis, who has had no engineering experience except in "appraisal" work for his father. Walter Bemis did not claim to have the qualifications to make any inventory, unit prices or appraisal of his own. Therefore he had to take as a starting-point for his process of subtraction, deduction and decimation an estimate by Mr. Carter. For obvious reasons, he did not wish to start with Mr. Carter's 1923-24 figure of $19,500,000 for the physical property alone. So he took an earlier computation by Mr. Carter, based on unit prices averaged from 1911 through 1920. *This enabled him to avoid giving any weight to unit prices or wages since 1920.*

From this sum, plus net additions at actual cost, he first deducted a large sum for "accrued theoretical depreciation," based on "life-table" expectancies.

From Mr. Carter's figure as already unsoundly decimated, young Mr. Bemis made the following further deductions, to reach "the City's reproduction cost appraisal" (City's Exhibit No. 60; Appellants' Brief, pages 20 and 21, 83 and 84):

(1) *Excess of Mr. Carter's "overheads" (undistributed costs)* over such amounts as Mr. Perk segregated from some of the books. The unsoundness of this deduction, amounting to $1,898,049, as to the Carter appraisal, as well as the unsoundness of the elimination of *all* of the "overheads," as attempted on page 81 of the appellants' brief, were discussed on pages 74 to 77, *ante,* in connection with Mr. Hagenah's valuation.

(2) *"Depreciation reserve invested in property,"* claimed to amount to $644,749 as to the Carter figure. This item was discussed on pages 80 and 81, *ante.*

(3) *"Property paid for through operating expenses,"* claimed in this instance to amount to $583,509 (Brief, page 83). This item was discussed at pages 77 to 79, *ante.*

(4) *"Canal exclusive of land,"* for which it is proposed to deduct $1,049,447. Both the Commission and Mr. Carter have demonstrated the unsoundness of this deduction, which was discussed on pages 81 to 86, *ante.*

(5) *"Too small accrued depreciation allowance,"* claimed to call for cutting off $2,000,000. Mr. Carter's $19,500,000 figure for the physical property only was *after deducting all the depreciation, of all kinds and varieties, he could find in the appellee's property.* The Commission did not, and could not, find that his estimate of depreciation was too low; in fact and in law it was too high. The impropriety of this deduction was discussed at page 87, *ante.*

(6) *"Materials and supplies"* amounting to $102,997. On page 81 of their brief, the appellants deduct, as did young Mr. Bemis, $102,997 for "materials and supplies," from Mr. Carter's value of physical property as of January 1, 1924. This elimination is utterly uncalled for. Mr. Carter's $19,500,000 figure contained no allowance for going value, water rights, cash working capital, accounts receivable, etc. It

covered only the *physical* property (depreciated). Among the useful *physical* property of the appellee, the Commission's engineer found and inventoried $102,997 of materials and supplies. Mr. Bemis and the appellants alike suggested no reasons why the appellee should not be allowed a return on this property. There are no reasons, but the appellants know they need to eliminate everything.

(7) *"Accumulation of canal right-of-way and land damages,"* amounting to $280,000 (Brief, page 84).

Mr. Carter allowed $150,000 for land damages and $130,000 for accumulation of canal right-of-way (R. 128). No witness for the appellee testified to or included these elements *as such*. Even with these elements included with the land, Mr. Carter's figure of $19,500,000 for the physical property only, includes the appellee's land at less than the *undisputed* testimony as to the market value of the appellee's land (see page 30, *ante*).

(8) *"Non-operative property,"* in the sum of $648,921. Mr. Bemis, like the appellants, *claimed* that in Mr. Carter's estimate, for the Commission and the Court, of the used and useful property of the appellee, the Commission's engineer included $648,921 of non-operative property. The facts as to the property and as to what Mr. Carter actually did are reviewed on pages 87 to 90, *ante*. On no possible theory of the law, the facts, or judicial discretion, would there be right or reason in eliminating this $648,921 or any substantial part of it.

That the appellant Commission, as well as Mr. Bemis and the municipal intervenor, would resort to, and argue for, such ill-considered and unfounded deductions as are above discussed, is the best index to the way in which the valuation of $15,260,400 was arrived at, and reveals the

unreliable and arbitrary character of the Commission's processes in rate matters.

Having thus obtained what he called "cost of reproduction new less depreciation" (Brief, page 21), Mr. Bemis then proceeded, for good measure, *further* to deduct:

> (1) *Structural overheads on the land,* discussed in connection with other property, on pages 74 to 77, *ante;* and his
>
> (2) *Cast iron pipe "adjustment,"* discussed on pages 92 and 93, *ante.*

We submit that Judge Geiger was fully warranted in refusing to adopt or attach weight to "the City's reproduction cost appraisal," which gave no weight whatever to wages or prices since 1920 and was cut below $19,000,000 only by the most indefensible of deductions.

V

THE COMMISSION'S DECREASE OF $1,194,600 IN ITS VALUATION OF THE COMPANY'S PROPERTY, FROM JANUARY TO NOVEMBER OF 1923, WAS ARBITRARY AND UNEXPLAINED

There are three types of cases in which it is the right and duty of the Courts to restrain acts of a regulatory body:

> (1) *Rates which are confiscatory.* A Commission may not regulate *rates* so as to reduce *earnings* below the limit of regulatory jurisdiction imposed by the Fourteenth Amendment.
>
> (2) *Interferences with sound management and business judgment.* These also are excluded from

the regulatory province, by virtue of the Fourteenth Amendment.

(3) *Arbitrary orders or actions unsupported by evidence.* These are foreign to due process, are beyond the power of a Commission, and are illegal.

See:

State of Missouri ex rel. Southwestern Bell Telephone Co. v. *Public Service Commission of Missouri,* 262 U. S. 276, 288-89;

Ohio Utilities Co. v. *Public Utilities Comn. of Ohio,* 267 U. S. 359;

Northern Pacific Ry. Co. v. *Department of Public Works of Washington,* 268 U. S. 39;

Banton v. *Belt Line Railway Corporation,* 268 U. S. 413, 421;

Kings County Lighting Co. v. *Prendergast,* 7 Fed. (2nd), 192;

Streator Aqueduct Co. v. *Smith,* 295 Fed. 385;

City of Erie v. *Public Service Commission,* 278 Pa. St. 512; 123 Atl. 471;

Kansas v. *Southwestern Bell Tel. Co.,* 115 Kans. 236; 223 Pac. 771;

People ex rel. Delaware and Hudson Co. v. *Stevens,* 197 N. Y. 1;

New York and Richmond Gas Co. v. *Prendergast,* 10 Fed. (2nd) 167; P. U. R. 1925E, page 19;

Los Angeles and Salt Lake R. R. Co. v. *United States,* 8 Fed. (2nd) 747;

Citizens' Gas Co. of Hannibal v. *Public Service Commission of Missouri,* 8 Fed. (2nd) 632;

Havre de Grace and P. Co. v. *Towers,* 132 Md. 16.

A finding of decrease in value, without evidence to support and justify it, is arbitrary, useless and inconsistent with justice.

> *Interstate Commerce Commission* v. *Louisville and Nashville R.R. Co.*, 227 U. S. 88;
> *Oklahoma Natural Gas Co.* v. *Corporation Commission*, 216 Pac. 917.

The January valuation in Case No. 6613

The rates here complained of are not only confiscatory but were the product of a valuation that was palpably arbitrary, unexplained and unsupported.

On June 1, 1922, the present appellee petitioned the Commission to value its property, pursuant to Section 9 of the Indiana Utility Act, which provides:

> "The Commission shall *value all the property* of every public utility used and useful for the convenience of the public. *As one of the elements in such valuation, the Commission shall give weight to the reasonable cost of bringing the property to its then state of efficiency*" (Burns' R. S. 1914, Sec. 10052, i).

After hearing evidence presented by the Commission's own staff, as well as by the City and the company, the Commission, by an order entered on January 2, 1923, in its Case No. 6613 *(Re Indianapolis Water Co.*, P. U. R. 1923D, 449), fixed the value of the company's property at $16,455,000, made up as follows:

Tangible property (fixed capital)	$14,904,000
Going value and water rights	1,416,000
Working capital	135,000
Total fixed by order of January 2, 1923, in Case No. 6613	$16,455,000

This valuation by the order of January 2, 1923, was made as of October 31, 1922. As of that date, the company had proved that the reproduction cost of its property (less depreciation) was $22,182,193, based on wages, prices and construction costs as of 1922 (R. 224, 225).

Nevertheless, the Commission adopted the figure—less by $5,727,193—arrived at by its own staff under the direction of its chief engineer, Mr. Carter (R. 224, 242). This *minimum* figure of $16,455,000 was the lowest that had been presented on any basis which gave any weight to the present price level. It had been reached by taking *average prices and wages for a ten-year period ended December 31, 1921* (R. 224, 242). This had been done despite the fact that the period taken had ended more than a year before the order was entered.

Such a ten-year average from 1912 through 1921 was of course preponderantly weighted with pre-war costs, and gave relatively little weight to the costs prevailing since 1918.

The City of Indianapolis intervened in Case No. 6613 and presented evidence before the Commission, but it especially urged that *original cost* be considered in fixing present value (R. 221), although, as the Commission pointed out, the Indiana statute above quoted

> "does not mention original cost, historical cost, original investment, or prudent investment" (R. 222).

In view of the fact that the Commission's January valuation of $14,904,000 for the physical property only was $4,543,193 less than replacement cost (less depreciation), as of October 1, 1922 (R. 25), the Commission accurately said, concerning its *January* valuation:

> "There is *no doubt* the element of original cost

has been recognized sufficiently. *There is doubt as to whether or not the element of the cost of reproduction new today has been given sufficient weight''* (R. 239).

The November valuation in Case No. 7080

In the summer of 1923, the company found that its existing rates limited its earnings to an extent which menaced its capacity for growth and good service. On June 8, 1923, it petitioned for adequate rates, and on July 14, 1923, it filed an amended petition which proposed a definitive schedule.

The Commission's attention was called to the fact that extensions and betterments since the last valuation amounted to $750,000, and that the company would be compelled to spend approximately $4,500,000 during the next three to five years, properly to care for the water necessities of the community; further, that approximately $3,000,000 of such additional investment would make no immediate or direct increase in its volume of business or revenues, but "are required to strengthen service conditions and to maintain a proper standard of water service for fire prevention purposes" (R. 7).

As we have indicated on pages 6 and 7, *ante,* the values *proved,* in behalf of the company and the Commission, at the hearings in Case No. 7080, upon this petition, were naturally and necessarily higher than those which had been proved in Case No. 6613. Wages, prices and construction costs had advanced; new property had been added; and any ten-year or five-year averages to the later date gave a larger weight to the higher price levels of the later years.

Nevertheless, by an order entered on November 28, 1923

(Re Indianapolis Water Co., P. U. R. 1924B, page 306), the Commission fixed a schedule of rates much lower than the company had contended for as necessary (R. 8-34). To enable it to fix these lower rates, the order of the Commission fixed the value of the company's property as of May 31, 1923, at $15,260,400 (R. 32), made up as follows:

Tangible property (fixed capital)	$14,280,400
Going value, working capital and water rights	980,000
Total fixed by order of November 28, 1923, in Case No. 7080	$15,260,400

This valuation was made by an order dated *eleven months* later than the order which fixed a valuation of $16,455,000., and the valuation in Case No. 7080 was as of a date *only seven months later* than the valuation date in Case No. 6613.

Leaving out of account all net additions actually made since October 31, 1922, and giving no consideration to any of the $4,500,000 of capital expenditures prospectively necessary, the valuation in the November order was $1,194,600 *less than that of the January order.* The tangible property was reduced $623,600, and the working capital, going value and water rights were merged and confused into a single item, less by $571,000 than the *minimum* amount allowed for those property elements in the January order.

Lack of explanation of such arbitrary decrease

This *reduction* in the valuation of the appellee's property, from October 31, 1922, to May 1, 1923, is unexplained by the Commission and unexplained by the record:

(a) *Wages and prices had not declined from October 31, 1922, to May 1, 1923.*

On the contrary, the appellant Commission recognized that they had *increased* (R. 25).

(b) *Ten-year and five-year averages as of a later date would not be lower.*

On the contrary, such averages of wages, prices and construction costs were *increased,* by being brought down to a date which gave greater weight to post-war costs and lesser weight to pre-war costs (See R. 132 and pages 8 to 11, *ante*).

(c) *Changes in the classification of property, by eliminating any claimed not to be used and useful in the water business, does not explain the reduction in the valuation.*

The facts as to the appellee's property and the testimony as to the use of it are reviewed on pages 87 to 90, *ante*. Even the appellants' *claims* as to the amount of non-operative property are nowhere near sufficient to explain the decreased valuation; actually, the Commission made no finding, in its Case No. 7080, that any particular property of the appellee was not useful in its water business.

(d) *Any claim that the Indiana law recognizes two different kinds of "value" of utility property, is unsound and unsupported.*

It clearly is no answer to say, as appellants do, that Order No. 6613 was issued in a proceeding originating in a petition seeking authority to issue securities. The Indiana Public Service Commission Act authorizes *only one kind of valuation* of a utility's property; as quoted on page

101, *ante*, the statute does not provide for or permit one method of valuation for rate-making purposes and another method or basis of valuation for securities-issuing purposes. The Supreme Court of Indiana has ruled, in the *Columbus Gas Light Company* case, that in any valuation of utility property, *present value* must be ascertained, under the rule of the *Bluefield* case. *Cf. Los Angeles and Salt Lake Railroad Co.* v. *United States*, 8 Fed. (2nd) 747.

VI

THE TRIAL COURT'S MINIMUM FIGURE OF $19,000,000 DID NOT GIVE UNDUE WEIGHT, AS A MATTER OF LAW OR AS A MATTER OF FACT, TO "CONSTRUCTION COSTS, CONDITIONS, WAGES AND PRICES AFFECTING VALUE" AT THE TIME OF THE VALUATION; THE TRIAL COURT CORRECTLY FOUND THAT, ON THE OTHER HAND, THE COMMISSION'S RATES HAD BEEN BASED UPON A "VALUATION" WHICH "CONSIDERED" PRESENT COSTS ONLY BY IGNORING THEM.

The independent judgment of the District Court was that the value of the appellee's useful property, as of May 1, 1923, and the intervening dates down to the entry of the decree of October 3, 1924, "was and is *not less than* $19,000,000" (R. 56) and was and is in fact several million dollars more (R. 64).

Although it is true, as this Court pointed out in the *Brooks-Scanlon Corporation* case, that "replacement cost is not *necessarily* the sole measure of or guide to value," we submit that in view of the facts summarized in the tables on pages 8 to 11 and 26 to 30, *ante*, the independent judgment of the Trial Court, in reaching a valuation of $19,000,000, cannot be said to have given too much weight to costs as of the time of the inquiry.

(A) Recent decisions of the State and Federal Courts uniformly sustain such a determination as the Trial Court made, upon the facts of this case, and as uniformly reject a valuation based on any such formula as this Commission palpably used.

We have shown that the *lowest* figure presented to the District Court on any basis which gave any weight whatever to prices or wages in 1923, was that of the Commission's engineer (Mr. Carter), who applied to his own inventory his own *ten-year averaged unit prices,* and thereby obtained the *minimum* figure of $17,006,370 (R. 132), for only the physical property (depreciated). Any reasonable allowance for going value, water rights, and working capital other than materials and supplies, would bring this figure to approximately $20,000,000. As against this figure, the District Court allowed $19,000,000, and the Commission allowed only $15,260,400, for *all* of the property, which latter figure closely resembles the putative "replacement cost" obtained by applying averaged 1911-1920 unit prices (R. 24), deducting "accrued straight-line depreciation," and adding $980,000 for going value, working capital and water rights.

Even if the Commission or the District Court had valued the property at $17,006,370 *plus* reasonable allowances for going value, working capital, and water rights, a "present value" reached by a ten-year average heavily weighted with the costs prevailing before 1918, could not be regarded as giving undue or excessive, much less exclusive or dominant, weight to replacement costs in 1923 and 1924. Wholly unrepresentative of present value, under the concensus of State and Federal decisions of the past few years, is a figure which is frankly indicated (Appellants' brief, pages 20 and 21) to have been derived from a ten-year average wholly antedating 1921, 1922, 1923, and 1924.

Neither the appellant Commission nor the intervening City of Indianapolis could contend in the State Courts of Indiana that the Commission had soundly determined the present value of the appellee's property, or that the District Court has fixed an excessive sum. In *Columbus Gas Light Co.* v. *Public Service Commission* (193 Ind. 399; 140 N. E. 538), the Commission had fixed the valuation of a gas property in a sum which exceeded original cost but was less than reproduction cost at the time of inquiry. The admitted basis was the application of "the ten-year average cost for the last preceding and completed ten years" (R. 23-25). The Supreme Court of Indiana held that this basis was inadequate and erroneous, and adopted for that State the rule of the *Bluefield* case and the *Southwestern Bell Telephone Company* case.

The Indiana Supreme Court did no more than direct that the appellant Commission should adhere to the rule adopted by most of the State and Federal jurisdictions:

In *City of Erie* v. *Public Service Commission* (278 Pa. 512; 123 Atl. 471), the Supreme Court of Pennsylvania reversed a ruling of the Superior Court which had valued the property of the appellant gas company on a basis of *averaged* prices which gave dominant weight to pre-war costs.

In *Citizens' Gas Company of Hannibal* v. *Public Service Commission of Missouri* (8 Fed. [2nd] 632), it appeared that the estimates of "value" presented by the engineers for the Commission had used prices based only on original cost, and "allowed nothing for current prices." Judge Reeves therefore ruled that "the Court must reject all the evidence offered by the Commission to sustain its valuation of the utility properties."

In *Adirondack Power and Light Co.* v. *Public Service*

Commission (211 App. Div. 272), the Court found that the New York Commission

> "has ignored present (1921) reproductive costs of the relator's properties in determining their present values and has adopted a rate base *which only squares with reproductive cost based on ten years' average prices covering the ten-year period prior to 1921, less depreciation.*"

The Court therefore reversed and set aside the Commission's finding as contrary to law.

In *Greensburg Water Co.* v. *Public Service Commission of Indiana* (not yet officially reported), the Honorable Charles Martindale, Master in Chancery, filed in the Federal Court on February 19, 1926, his report which adjudged as confiscatory a schedule of water rates prescribed by the defendant Commission on May 25, 1925. The Commission had fixed the value of the water company's property, as of February 1, 1924, at $310,000. The company's engineering witness testified that the reproduction value of the property (depreciated), as of January 1, 1926, was $494,114. The Commission's engineer (Mr. Carter) valued the property using "spot" prices as of the same date, at $400,632; on a ten-year average ending December 31, 1925, at $380,443; on five-year average prices, at $397,451. He estimated the original or historical cost at $219,352. Judge Martindale fixed the value of the water company's property at $425,000, and enjoined the Commission's rates accordingly.

In *New York Telephone Co.* v. *Prendergast* (300 Fed. 822), the Commission's valuation had been based on a cost as of a pre-war date, plus net additions at actual cost through the war period, with something added to "transmogrify" such figures into "normal" present replacement

cost. The Special Statutory Court held this was no way to give dominant effect to present wages and prices.

In *Matter of Peoples' Gas and Electric Company of Oswego* v. *Public Service Commission* (214 App. Div. 108), the company had proved before the Commission replacement cost new (less depreciation) at present wages and prices. The municipality proved what it called a "*normal* reproduction cost," at *averaged* unit prices, and the Commission's accountant proved the original cost of the same property. After carefully reviewing the decisions, the New York Court unanimously held that upon such a state of the record, the company had offered *the only proof pertinent to present value.* Replacement costs derived from *averaged* unit prices were held not to give due regard to *present* "construction costs, conditions, wages and prices."

In *Elizabethtown Gas Light Co.* v. *Board of Public Utility Commissioners (supra),* the New Jersey Supreme Court (per Swayze, *J.*) held that in the new price level which has followed the war, unit prices and rates of pay as of the present time must be given *full rather than partial weight,* in determining present value.

In *Ashland Water Co.* v. *Railroad Commission of Wisconsin* (7 Fed. [2nd], 924), Judge Geiger had before him, in the Special Statutory Court, the Commission valuation of a water company's property, which was *less* than would have been produced by applying unit prices for ten years prior to the valuation date. The Commission's figure had evidently been derived by applying to the property in existence on January 1, 1916, the average unit prices for the ten-year period preceding this date. The resultant figure had then been *appreciated* 15 per cent., and net additions to January 1, 1924, had been added at actual cost per books. For reasons and authority quoted on pages 69 and 70, *ante,* Judge Geiger held that this method was arbitrary and

failed, as a matter of law, to give dominant or due weight to prices and wages prevailing in 1924.

The situation in the case here at bar is not unlike that before Judge Rellstab, in the New Jersey District, on January 7, 1926, in *Middlesex Water Co.* v. *Board of Public Utility Commissioners,* 10 Fed. (2nd) 517; 28 Rate Research, 89. At pre-war prices (1915) plus net additions at cost, the cost of that water company's property amounted to $1,416,000. At "trend" prices and with net additions down to 1924, the same property amounted to $2,611,817. At current replacement cost, the property had a value of $3,215,065. The Commission found a value of $2,113,909. In the District Court, the water company claimed a value of not less than $2,500,000. as sufficient to show that the Commission's rates were confiscatory. The Master made this minimum finding, and Judge Rellstab adopted it, holding that the Commission had failed "to follow the reproduction cost new test."

(B) The Commission's valuation of November 28, 1923, allowed virtually nothing in excess of the original cost of the property (including land at market value).

The failure of the Commission to give "due regard to construction cost, conditions, wages and prices affecting value" as of 1923, may be further emphasized by the following computation: The history of the property owned and used by the appellee goes back to 1870, under private ownership, and the history of part of the property goes back many years more, under public proprietorship. Perhaps naturally, for reasons which are explained in detail on pages 134-140, *post,* the actual original cost of the property now owned and used by the appellee cannot be ascertained with even approximate accuracy and cannot be regarded as "a useful guide" to anything. On a conservative basis, however, the original cost of the property

other than land, plus land at its market value, and plus a reasonable allowance for working capital, equals or approximates $13,000,000 (R. 182). If to this sum we add even the moderate allowances made by the Commission for going value and water rights, in its order in Case No. 6613, the result is approximately $14,500,000. This conservative figure is only about $750,000 less than the total value of the appellee's property as found in the Commission's order here complained of.

Bearing in mind this figure of $750,000, it may be interesting to consider momentarily the following facts shown *uncontrovertibly* by this record:

(1) The Commission's own chief engineer, using land values $345,000 lower than the *undisputed* testimony of the only qualified witness as to land values, admitted that the replacement cost *(depreciated)* of the appellee's *physical property only,* at 1923 prices and wages, was $19,500,000 (R. 132), which is $6,500,000 more than the ascertainable original cost of the appellee's *physical property,* including land at market value and working capital.

(2) The appellee's engineers testified that the replacement cost *(depreciated)* of the appellee's *physical property only,* at 1923 prices and wages, was *at least* $22,500,000 (and in fact more), which sum is at least $9,500,000 more than the original cost of the appellee's *physical property,* including land at present value and working capital.

(3) Average these two figures of $6,500,000 and at least $9,500,000, and you have at least $8,000,000 as an *averaged* judgment as to the increase in the value (over original cost) of the appellee's *physical property* only, on the basis of 1923 prices, with full deduction for depreciation.

(4) To represent this increase of at least $8,000,000 in the present replacement cost (depreciated) over original cost of the structural property only, the defendant Commission allowed, in fixing

the appellee's "rate base," not more than the sum of $750,000, as demonstrated above.

Did the Commission, in so doing, give "real consideration" to present prices? Did the Commission, in so doing, make "an honest and intelligent forecast of probable future values"? Was there anything in the record or within the realm of economic facts known to the Commission which indicated a probable decrease of $8,000,000 in the value of appellee's structural properties in the immediate future? Obviously not; and equally obviously, the Commission, in so doing, essentially and actually "ignored prices of today."

(C) The Commission's valuation of November 28, 1923, must be deemed to have made no allowance whatever for any increase since 1917 in wages, prices or conditions affecting the construction cost or present value of the appellee's structural property.

In its order of January 2, 1923, in its Case No. 6613, the Commission had fixed $16,455,000 as the value as of October 31, 1922, adopting virtually the lowest valuation that had been proved before it on any basis (R. 224-225) and expressing frankly its own doubt whether current replacement cost had been given sufficient weight in reaching that figure (R. 239). As shown on page 102, *ante*, the $16,455,000 figure was derived from a ten-year average, ending in 1921, which gave the least possible weight to costs, wages and prices since the World War.

If there was doubt, even in the minds of members of the Commission, whether the January valuation gave sufficient weight to current wages and prices (R. 239), *there can be no doubt* that the November valuation of $15,260,400 (almost $1,200,000 lower for a larger amount of property)

failed utterly to give proper consideration to "construction costs, conditions, wages and prices affecting value" as of 1923, and that the District Court was right in concluding that the Commission had "considered" those factors only by ignoring them (R. 62).

In the paragraph numbered 3, on page 41 of the appellants' brief, it is said that

> "the Commission did not disregard the engineers' estimate of spot reproduction cost. No less than $3,626,833.41 was allowed for appreciation in value accrued after March 21, 1921, and the estimates of spot reproduction was the only evidence in which the allowance for appreciation could rest."

Something of the same import is carried on pages 59 and 60 of the appellants' brief; and on pages 61 and 62, appellants undertake to demonstrate that some substantial allowance was made by the Commission's valuation of November 28, 1923.

All of these computations are fallacious and misleading, and fail to show that proper weight was given to "construction costs, conditions, wages and prices affecting value" at the date of the valuation.

Each of these computations is based on the unproved and false premise of the adequacy of early "valuations" made by the Commission, to reflect "present value" as of those earlier dates. The fact is that nearly all of those prior "valuations," before 1923, were made on a basis amounting virtually to estimated original or historical cost less accrued theoretical depreciation and various other deductions. To add net additions at book cost to these abbreviated estimates of original cost less a theoretical depreciation, could not give present value in 1923. Naturally, such a fallacious selection of starting point produces some

pretext of support for a claim that the November (1923) valuation allowed for some appreciation.

Any such method of harking back to inadequate "valuations" in the "original cost" era of valuation, is hardly a useful guide to *present value;* but the following computation may throw some light on the appellants' claims:

In 1917, in its Case No. 1400, the Commission made a "valuation" of the appellee's property, on virtually *original cost basis* (*Re Indianapolis Water Co.,* P. U. R. 1917E, page 556). In fact, its finding of "not less than $9,500,000" was something less than original structural cost plus the *land* taken at its 1917 market value. This 1917 order is substantially set forth in the transcript (R. 201 to 216). In its order No. 1400, the Commission conceded that, as of 1917:

> "The property now owned and used by the Indianapolis Water Company could not be duplicated today for less than $12,500,000" (R. 215).

And the Commission in its Order No. 6613, in January of 1923, quoted the above statement from Order No. 1400 and said: *"There is no reason to question the correctness of that statement,"* as of the 1917 date.

In other words, from 1870 to the beginning of 1917, there had been an appreciation or increase in replacement cost over original cost, amounting to $3,000,000 as to the structural property alone, *which the Commission nevertheless did not allow or give weight to, in fixing a "rate base" as of early 1917.*

From December 31, 1916, to December 31, 1923, there was added, in extensions and betterments to the company's property, the sum of $2,503,862 (R. 328; fol. 384). All of the company's land *originally cost* $818,079 (R. 182). In its order in Case No. 1400, in 1917, the Commission found that the appreciation in land value to January 1, 1917, was

at least $1,500,000 (R. 215). The only evidence as to the market value of land on January 1, 1924, before the District Court in the present case, was that given by the witness McCloskey, whose appraisal of land amounted to $3,014,627 (R. 261). Deducting the original cost of the real estate from the present appraisal shows an appreciation in land alone of $2,196,548 since the land was first bought, or of $696,548 since December 31, 1916.

The mathematics of this phase of the case are therefore as follows: Adding to the 1917 reproduction value ($12,500,000) found by the Commission in Case No. 1400, the appreciation in *land* since December 31, 1916 ($696,548), and the additions and betterments (net), at actual cost per books, since the order in Case No. 1400 ($2,503,862), gives a total, as of 1923, of $15,700,410, which is actually $440,010 more than the Commission found the value of the property to be, in its order of November 28, 1923. The element of any depreciation since 1917 could not fully explain this net decrease of $440,010.

In fact, further analysis of the figures reveals a situation still more demonstrative of the arbitrary and unsupported character of the valuation on which were based the rates enjoined by the District Court. The 1917 order in Case No. 1400, being based strictly on original cost as to structural properties, allowed only $300,000 for going value, $75,000 for cash working capital and nothing for water rights—a total of $375,000. The order here complained of (November 28, 1923) allowed $980,000 for these three elements of property—an increase of $605,000. Adding the increased figure for these three items, from 1917 to 1923, to the net decrease of $440,010, shown above for *all* elements of property, demonstrates a failure on the part of the Commission, by the sum of $1,045,010, to recognize that the structural property, in 1923, had appreciated at all since 1917 or had a replacement value as high as in 1917.

VII

THE TRIAL COURT'S CONCLUSION THAT THE RATES ARE CONFISCATORY IS PLAINLY CORRECT.

Regulation of rates should not be permitted to reduce below *eight* per cent. the earnings of the private capital embarked in the appellee's business.

(A) The Commission's rates were intended to yield less than seven per cent. upon its "rate base."

The appellant Commission confessed that its rate schedule was so framed that it might yield *less than* seven per cent. "for the immediate future" (R. 31), but expressed the hope that rapid growth of the appellee's business might make the rates yield an average of *seven* per cent.

The Trial Court found that on any reasonable basis of valuation and calculation, *provided the required return exceeds five per cent.*, the rates complained of are indisputably confiscatory (R. 64).

(B) An eight per cent. return upon present value is reasonably required.

The National market for money, for industrial and public service enterprises, has become highly competitive, and the return must be such as to enable the utilities to secure in this market the new money necessary for their business; and *eight* per cent. has been widely recognized as the customary and required rate.

Bluefield Water Works and Improvement Co. v. *Public Service Commission*, 262 U. S. 679;

City of Fort Smith v. *Southwestern Bell Telephone Co.*, 294 Fed. 102;——U. S.——; 46 Sup. Ct. Repr. 206; 70 L. Ed. 236; affirmance by this Court on January 25, 1926;

Michigan Public Utilities Commission v. *Michigan State Telephone Co.*, 228 Mich. 658; 200 N. W. 749;

Consolidated Gas Company of New York v. *Prendergast*, 6 Fed. (2nd) 243, 280;

Southwestern Bell Telephone Co. v. *Public Service Commission*, 262 U. S. 276;

Brush Electric Co. v. *Galveston*, 258 U. S. 388;

Lincoln Gas Co. v. *Lincoln*, 250 U. S. 256, 267;

Matter of Adirondack Power and Light Corpn. v. *Public Service Comn.*, 211 App. Div. 272, 275;

New York and Queens Gas Co. v. *Prendergast*, 1 Fed. (2nd) 351; appeal dismissed by this Court: 268 U. S. 708;

Matter of Peoples' Gas and Electric Co. of Oswego v. *Public Service Commission*, 214 App. Div. 108;

Kings County Lighting Co. v. *Prendergast*, 7 Fed. (2nd) 192, 218;

Brooklyn Union Gas Co. v. *Prendergast*, 7 Fed. (2nd) 628, 654, 672;

Pacific Gas and Electric Co. v. *San Francisco*, 273 Fed. 937, 945;

Alton Water Co. v. *Commerce Commission*, 279 Fed. 869;

Newton v. *Consolidated Gas Co.*, 258 U. S. 165; affg. 267 Fed. 231.

Pioneer Telephone and Tel. Co. v. *Westenhaver*, 29 Okl. 429; 118 Pac. 354;

McAlester Gas and Coke Co. v. *Corporation Commission*, 227 Pac. 83;

Indiana Bell Telephone Co. v. *Public Service Commission of Indiana,* 300 Fed. 190.

The rule of the *Bluefield* case, *supra,* that the return to be allowed utility investors must be determined by the competitive conditions of the money market, so as to give them equality of treatment with investors in other undertakings of "corresponding risks and uncertainties," has been specifically laid down, by the highest Court of Indiana, as the standard to guide and control the appellant Commission.

Columbus Gas Light Co. v. *Public Service Commission,* 193 Ind. 399; 140 N. E. 538.

Investors in a *new* public utility enterprise just completed and now being placed in operation, would be allowed to earn a return at the current rate upon the *present* cost to build or buy such a property. That would be the rule and basis of their return, under any theory of valuation. To prevent injustice and discrimination against the investors in existing utility enterprises, they must be allowed to earn a like return upon a commensurate amount.

> "If the investors were going to buy or build a property like that of the complainant, what amount would they feel that the property should earn in order to induce them to invest their money in the purchase or construction of such a property? Taking into consideration other classes of investment in this locality, with the comparative risks and return thereon, the rate of return generally required to secure proper credit for borrowing money and financing its operations, what should a utility company subject to state regulation be permitted to earn, in order that it might compete successfully with other businesses and be on a parity with them?"

Consolidated Gas Company v. *Prendergast,* 6 Fed. (2nd) 243, 273, 274, 280.

It is important to keep in mind that neither the Commission, the utility, nor the Court, can control what rate of return is required to prevent *starving* the utility. *That is determined by the investor,* who will not put in his money where it may be discriminated against.

City of Elizabeth v. *Board of Public Utility Commissioners of New Jersey,* 123 Atl. 358.

Detailed demonstration that the payment by a utility company of a Federal income tax and the inclusion of its amount as a part of the operating expenses (*Galveston Electric Company* case, 258 U. S. 388, 399) does not justify approving a rate of return appreciably less than would otherwise be compensatory, was made by Circuit Judge Denison, in the opinion of the Special Statutory Court on the recent further hearing in the *Monroe Gas Light Company* case, decided February 27, 1926.

The *rate of return* required for adequacy is not reflected or limited by the *dividend rate* which the net operating revenue produced thereby might yield upon the outstanding common stock of the enterprise. Rates may not be made to yield less than a reasonable return *upon the property,* and a reasonable return upon the *property* is not affected by any incident of the Company's financial structure or any *under*-capitalization or *over*-capitalization.

Consol[illegible]ed Gas Co. v. *Prendergast,* 6 Fed. (2nd) 243, 273, 274, 280.

In a great number of decisions of recent years, including most of those above cited, a return of eight per cent. upon present value has been commonly held to be required, as the margin below which the regulatory power may not reduce the earnings of a utility. In a number of these cases, rates fixed by a Commission to yield seven per cent. or a little more have been held *confiscatory.*

The Special Statutory Court, in *New York Telephone Company* v. *Prendergast* (300 Fed. 822, 826), where the Commission, as here, had allowed a seven per cent. return, said:

> "Admittedly it is and has been customary to allow as a reasonable rate of return for regulated businesses like this one, eight per cent. The justification for the custom is the habit of business men, and *a departure therefrom is not right because a Court or Commission prefers a lower rate. Reasons are wanted, and none are set forth in this record.* Under such circumstances there is no presumption of correctness attaching to the seven per cent. limit. The question always raised in rate cases is this: What rate of return, with due regard to certainty and security, will attract the intelligent investor? *It remains to be seen whether a departure from the present customary rate is warranted by modern conditions.*"

Although the market for money is now Nation-wide (*Pacific Gas and Electric Co.* v. *San Francisco*, 273 Fed. 937, 945) and particular local conditions may have only negative effect on the cost of money for a particular utility, the fact that a return of eight per cent. has been repeatedly allowed and upheld, for telephone, gas, electric and other utilities, in and near New York City, does not suggest that a lower rate is reasonable in the rest of the country or that a rate designed by the Commission to yield "below seven per cent." "for the immediate future" can escape the constitutional condemnation.

As recently as March 10, 1926, the Special Statutory Court, in the *New York Telephone Company* case, ruled that an *eight* per cent. return must be allowed by regulatory authority.

The facts

Mr. Hagenah testified that the return required to induce investment in this company, in competition with other industries, was eight per cent. (R. 76, 85). "You cannot finance a public utility on the legal rate" (R. 85). Mr. Elmes said that the rate should *net* about eight per cent. (R. 96). Mr. Metcalf testified to the need for seven and one-half to eight per cent. (R. 122).

Against this informed and experienced judgment, the Commission adhered to Professor Bemis and purported to base its seven per cent. solely on his testimony (R. 31).

Professor Bemis' own Exhibit No. 62 belied his estimate: His selected list showed the return in 1923, to investors *in utility bonds alone,* to average 6.3 per cent., to which he said 0.4 per cent. should be added as the cost to the utility of marketing its bonds. This addition is absurdly low, but it makes the average, on *bond* money alone, at least 6.7 per cent., on which basis the average cost of *all* the required money would exceed *eight* per cent.

Professor Bemis' table as to the 1923 cost of *preferred stock* money shows an average of nearly *eight* per cent., on which basis the *common stock* financing would cost much more than eight per cent., making the average cost of all the required new money *more than eight per cent.*

But the rate at which a utility can get the small amount of *new* money required for current additions, does not determine the rate of return to which existing investors are entitled. For example, a utility which has $100,000,000 of property and no mortgage or bonds outstanding, could get $10,000,000 of new capital, by an issue of bonds, for less than *six* per cent., but that would not mean that the owners of the $100,000,000 of *existing* property should receive on it a return of less than six per cent.

(C) The amount available for return, under the rates complained of, is so low as to make them clearly confiscatory.

Mr. Metcalf, consulting engineer for the Company, estimated that the amount available for return in the year 1924, under the rates fixed by the order complained of, after payment of operating expenses and taxes, would be $958,000 (R. 117-120, 254). Mr. Perk, the accountant for the City, estimated that it would be $1,121,550 (R. 333). Mr. Perk is an accountant without any operating or practical experience. Mr. Metcalf is a waterworks engineer with years of experience and a national reputation.

As shown on pages 12 and 13, *ante*, the difference between the estimates of these two witnesses occurs largely by reason of Mr. Perk's estimate of gross revenue being $67,758.92 higher than Mr. Metcalf's, and his estimate of operating expenses being $95,791.27 lower than Mr. Metcalf's (R. 333-335; 248, fol. 301; 254). Mr. Metcalf's estimate of revenue is substantially supported by Mr. Jirgal (R. 245), a certified public accountant, who made a complete analysis of the records and financial experience of the company, which was a task of considerable magnitude, requiring a force of five or six men for two months' time (R. 111).

Without support in the evidence or any judgment based on experience, Mr. Perk added $67,758.92 to Mr. Metcalf's soundly-conceived estimate of the gross revenues. This assumption of increased revenues must be rejected and disregarded. In the absence of proof of abuse of discretion or gross error of judgment, on the part of the operating executives of the appellee, the actual operating expenses, as reflected in the accounts kept under the supervision of the Commission, must control, rather than hypothetical estimates.

See cases cited on page 100, *ante*.

The expense items in controversy

Mr. Perk also threw out of Mr. Metcalf's operating expenses two items and unwarrantedly reduced two others:

(1) *Expenses of rate and valuation proceedings:*

For many years, the appellee has had a recurring annual burden of expense, in connection with rate and valuation proceedings before the appellant Commission, and more recently in the Courts. It is not an "infrequent" or "unusual" expense, as to the appellee (R. 118; 248, fol. 301).

The more recent trend of view is that such expense of proceedings before the Commissions, and even of proceedings in the Courts, should be included and allowed in the operating expenses of the year in which they are incurred.

New York and Queens Gas Co. v. *Prendergast,* 1 Fed. (2nd) 351; appeal dismissed 268 U. S. 708;

Alpha Portland Cement Co. v. *Lehigh Nav. El. Co.,* P. U. R. 1924E, page 737 (Pennsylvania Public Service Commission);

Re Consolidated Gas, El. L. & P. Co. of Baltimore, P. U. R. 1924D, page 177 (Maryland Public Service Commission);

Consolidated Gas Company of New York v. *Prendergast,* 6 Fed. (2nd) 243, 280.

The earlier, and perhaps still the prevailing, view is that the expenses of rate litigation, at least that in Court, should be pro-rated over a short period.

Streator Aqueduct Co. v. *Smith,* 295 Fed. 385, 391;

Consolidated Gas Co. v. *Newton,* 267 Fed. 231; affd. 258 U. S. 165;

New York and Richmond Gas Co. v. *Prendergast,* 10 Fed. (2nd) 167; P. U. R. 1925E, page 19;

Mobile Gas Co. v. *Patterson,* 293 Fed. 208, 224;

Monroe Gas Light and Fuel Co. v. *Michigan Public Utilities Commission,* Fed. (2nd) (Spec. Stat. Ct.); decided February 27, 1926; S. C. on preliminary injunction: 292 Fed. 139.

The latter rule was applied, as recently as February 19, 1926, to the Greensburg Water Company, in its suit against the Indiana Public Service Commission, by the Honorable Charles Martindale, Master in Chancery, whose opinion has not yet been officially reported.

All expense incurred by reason of public regulation is a cost incurred in rendering the service; and the appellee was clearly entitled to have its expenses of valuation proceedings included when and as incurred, or amortized over a short period. Mr. Metcalf proposed to pro-rate these expenses over a five-year period, which meant $25,000 per year (R. 118; 140; 248, fol. 301).

Neither the Commission nor the City questioned the accuracy of Mr. Metcalf's total figures, or gave any reason why a five-year period was too short or why this item is not a proper operating expense. Mr. Perk kept his "estimated" operating expenses down by the simple expedient of omitting any provision whatever for this item, and the appellants argue that it should be left out.

(2) *Retirement expense (provision for depreciation):*

The annual provision for depreciation (retirement expense) shown by Mr. Metcalf in his Exhibit No. 23, as to required operating expenses for 1924 (R. 248; fol. 301), is $135,000. He reached this by taking approximately four times the amount *actually* set aside, on the company's books, for the first three months of 1924. Mr. Jirgal's audit (for the company) and Mr. Boggs' audit (for the Commission) show the same figures for depreciation allowance. Mr. Boggs was on the stand as the accounting witness for the Commission, and did not question the book figures or Mr. Metcalf's estimate (R. 145, 308).

The appellants argue for the reduction of this $135,000 to $107,619, on the basis of Mr. Perk's exhibit. The way in which the company determined upon the sum of $135,000 was as follows: The depreciation provision in 1923 was shown by Mr. Boggs to be $89,610.12 (R. 308). In its opinion of November 28, 1923, the Commission found that the evidence showed, as of May 31, 1923, "the necessity for an increase in the depreciation reserve charge of approximately $37,000 per year" (R. 31).

Adding the 1923 actual to the increase authorized by the Commission gave $126,610.12. Making the same rate of provision as to property since that appraisal date gave approximately $135,000. The appellants nevertheless argue for Mr. Perk's figure of $107,619.

The appellant Commission does not (and could not) contend that it found, or that the evidence showed, that $135,000 is an excessive provision for this annual expense. The ground of attack (R. 31) was stated by the Commission as follows:

> "The evidence discloses that the company has been making a charge for depreciation on the basis

> of eight-tenths of one per cent. on a value which includes non-depreciable property. This, of course, is a wrong practice, as the Commission does not recognize depreciation on land, going value, water rights and working capital."

The Commission would admittedly have had the right and duty to see to it that the company did not burden its operating expenses with an *excessive* charge by way of provision for property retirements or depreciation. So long as the *method* of accrual is not claimed to produce an *excessive* burden on operating expenses, and so on the patrons of the service, we submit that the *method and basis* of the company's provision for this item is a function of management and not of regulation, and rests in the sound business judgment of the officers and directors of the utility.

> *City of Fort Smith* v. *Southwestern Bell Telephone Co.*, 294 Fed. 102, at page 108; —— U. S. ——; 46 Sup. Ct. Repr. 206; 70 L. Ed. 236; affirmance by this Court on January 25, 1926.

> See, also, the cases cited on page 100, *ante*.

Without suggesting that the amount set aside by the company is *too much*, the Commission claims that the company computes it by using a percentage which is applied to *all* of the property, including some which the Commission regards as non-depreciable.

We submit that the Commission has no proper concern with the percentage or basis of accrual or with the classes of property or operations to which it is applied, *so long as an excessive amount is not produced thereby.*

If the company narrowed the classes of property to which it applied the percentage, it would have to increase the percentage, to obtain the same annual accrual. But

we submit that bases and methods of provision are no proper concern of regulation, but are left to the judgment of the management.

As to retirement expense, the Uniform System of Accounts as drafted by the National Association of Railway and Utilities' Commissioners, and now in force in a majority of the States, provides:

> "An account is provided in which to include charges made in order that corporations shall, through the creation of adequate reserves, equalize from year to year, as nearly as is practicable, the losses incident to important retirements of buildings, dams, etc., or of large sections of continuous structures like electric line, or of definitely identifiable units of plant or equipment. 'Losses' used above means in each case the excess of the original cost to the accounting company of the property retired plus the cost of dismantling or removing, over its salvage value at the time of its retirement. The cost of replacing minor parts, which is not recorded by any entries in the fixed capital accounts, and which is commonly called the cost of 'repairs' or 'maintenance' as distinguished from the cost of 'replacements' of large units, need not be provided for through a retirement reserve. *The amounts charged to retirement expense plus amounts appropriated from surplus should be upon a basis determined to be equitable according to the accounting company's experience and best sources of information,* and should in all cases be sufficient to provide during a period of years a reserve against which can be written off all losses sustained upon the retirement of property for any cause whatsoever."

(3) *Increase in 1924 taxes:*

Mr. Metcalf, from his intimate knowledge of the appellee's affairs, estimated that the cost of taxes in 1924 would

be at least $101,200 more than in 1923 (R. 118-119; 140; 248; fol. 301; 250-253). *This testimony was uncontradicted by any witness,* but Mr. Perk allowed $60,392.74 less than Mr. Metcalf found necessary (R. 151-153). In this way Mr. Perk further kept down his estimate of operating expenses.

(4) *The amount allowed by the Commission's order to amortize its own erroneous estimate of the appellee's taxes:*

In a previous rate proceeding, the Commission had estimated the amount of the company's tax payments for the year 1920 at a given sum. In actual experience, this estimate was exceeded by $89,000 (R. 155, 31).

In the proceeding which led to its order of March 2, 1921 (R. 31), the Commission ruled that the company was entitled to amortize this excess of actuality over the Commission's estimate of the probable cost of taxes, and to charge $17,800 to its annual operating expenses, for a period of five years (R. 31, 155). Mr. Perk's estimate threw this all out (R. 151-153). In the *Columbus Gas Light Company* case, the Indiana Supreme Court upheld the propriety of the amortization of such an item.

This is one of the numerous items as to which the appellant Commission is *admittedly "embarassed and estopped."*

In this action, the appellant Commission cannot challenge an item allowed and included by its own order, and the intervening municipality cannot attack and review that order collaterally here.

See cases cited on pages 15 to 18, *ante.*

The net earnings under the Commission's rates undeniably insufficient.

By an unmistakable preponderance of the evidence, under sound rules of law, the net amount available for return from the water business in 1924 has been shown not to exceed the sum of $958,000 (R. 254).

As demonstrated on pages 13 and 14, *ante*, this sum would fail by $618,747, or by about 39 per cent., to yield the appellee an eight per cent. return on the minimum valuation found by the District Court. Such net earnings would amount to no more than 5.04 per cent. on $19,000,000, and to no more than 4.2 per cent. on a sum representative of the full value of the property (say $23,000,000).

Even the highest possible (and utterly unsound) estimate of the available return ($1,121,550 as conceived by Mr. Perk; R. 334-335) is, as shown on pages 13 and 14, *ante*, at least $455,197, or nearly 30 per cent., *less* than an eight per cent. return on the Court's *minimum* valuation of $19,000,000. On the same basis, it is more than $345,000 *less* than a 7½ per cent. return on the minimum valuation found by the District Court and at least $238,000 *less* than even a seven per cent. return on $19,000,000. Even Mr. Perk's inflated net earnings would amount to no more than 5.9 per cent. on the minimum value found by the District Court, and to less than 4.9 per cent. on $23,000,000.

The sound and experienced estimate of available return ($958,000 by the company's consulting engineer, Mr. Metcalf), is at least $618,747 *less* than an eight per cent. return on the *minimum* valuation of $19,000,000; at least $508,500 *less* than a 7.5 per cent. return on $19,000,000, and at least $401,750 *less* than a seven per cent. return on $19,000,000. This available return is seven per cent. on only

$13,690,000 and 5.04 per cent. on the Court's *minimum* valuation of $19,000,000. On any sum above $19,000,000, the net operating return would fail below five per cent.

It was the sound judgment and mature conclusion of Judge Geiger that, on any reasonable basis of calculation of the Company's property and its full present value, the amount left for return, under the rates complained of, would be confiscatory, *if more than five per cent. is required for adequacy* (R. 64).

VIII

REPLY TO OTHER MATTERS IN THE APPELLANTS' BRIEF

Under this point we shall refer to some of the *major* fallacies which seem to pervade the argument of the appellants, in support of their contention that the decree of the District Court should be reversed.

(A) General statement of fallacies and false assumptions in the appellants' brief.

Without attempting minute reply to every misapprehension on which the appellants have tried to erect an argument, it may be pointed out that practically every contention of the appellants' brief depends on one or more of the following false premises:

(1) That if the Commission made, five years ago, an abbreviated valuation on the basis of original cost less accrued "straight-line" depreciation and various other deductions, that sum may forever be taken as a starting-point, and that *present value*

may be ascertained, during the present price level, by adding to the prior valuation net additions at book cost plus a little bit more for the increase in going value, working capital, and water rights.

This idea of "valuation" was replied to and refuted on pages 22 to 26, and 106 to 116, ante.

(2) That property presumably purchased with undistributed net earnings does not belong to the company and is not entitled to earn a return, even though the company devotes it to the public service.

This idea was replied to and refuted by decisions, on pages 77 to 79, ante.

(3) That if the books show a balance in "depreciation reserve" (retirement reserve), it must be assumed that this likewise is invested in useful property and that accordingly this property must be deducted from the "rate base" and denied a return, as already belonging to the public.

This idea was replied to and refuted by decisions, on pages 80 and 81, ante.

(4) That reproduction value is a matter of *outlay,* and that both inventory and valuation are controlled by the *form of accounts,* so that every item must be eliminated from a present inventory and appraisal, unless it can be identified with a like item of outlay appearing on the books of the company.

This idea was replied to and refuted by decisions, on pages 74 and 75, and 22 to 26, ante, and 134 to 140, post.

(5) That because, in the exercise of its business discretion and patriotic judgment, the appellee deemed it better, during the period of the World War,

to accept rates and net earnings less than was its constitutional right, rather than litigate such rates at that time and contend then for rates yielding a full return on reproduction values then deemed abnormal, the appellee should be compelled for all time to render service at rates based on the valuation of its property at no more than pre-war construction costs, wages and prices, plus net additions.

This false premise is replied to and refuted by reference to the decisions, on pages 140 to 142, post.

(6) That the history of the appellee's property and the investment therein begins in 1881 and that a complete record of the property and its original cost may therefore omit the actual outlays and acquisitions during the first eleven years of the property's history.

The unsoundness of this assumption is discussed and demonstrated on pages 134 to 140, post.

(7) That the *original cost* of the appellee's property, and its *present value* as well, may be accurately and completely shown by taking the price paid on a forced sale and reorganization in 1881, and adding thereto 42 years of net additions at a *decimated* book cost *less* a theoretical, "life-table" depreciation.

The unsoundness of this premise is discussed and demonstrated by the citation of decisions, on pages 22 to 26, and 58 to 66, ante, and by the discussion on pages 134 to 140, post.

(8) That the appellee's past operations may be proved to have been remunerative and profitable, by showing purported "percentages of return," even

though such returns are computed on a "rate base" made up virtually of original cost less "straight-line" depreciation and less various other deductions and eliminations.

The unsoundness of this mode of computation, which pervades the appellants' whole brief, and the unsoundness of the various deductions, are shown on pages 78 and 79, ante, and pages 137 to 140, post.

(9) That the condition of a composite, complex operating property and the extent of any deterioration therein, is a theory and not a fact, a question of supposed age and not of actual condition; and that the existence and extent of depreciation, from whatever cause arising, may better be calculated by a theoretical formula by one who knows nothing of this or any other property, rather than by competent engineering estimate on the basis of a detailed inspection and report as to this particular property.

The unsoundness of this particular premise was discussed and demonstrated, with citation of the decisions, on pages 57 to 68, ante.

(B) The original cost of the appellee's property

As indicated on page 112, *ante*, the history of the property owned and used by the appellee extends back to 1870, under private ownership, and several decades further, under public proprietorship. On a conservative basis, the original cost of the appellee's property, in so far as the same can be ascertained from the books and records in its possession, approximates $13,000,000, with land included at its market value (R. 182). From 1870 down to the establishment of regulatory accounting in 1913, the accounts and records of the present company and its predecessor did not draw and observe always the present distinctions between fixed capital and operating expenses.

The difficulty of ascertaining the *actual* original cost or investment of an enterprise commenced and conducted long prior to its supervision by a regulatory body, and whose records have not been kept according to established uniform classified accounts, has long been recognized. It is a matter of common knowledge (and of evidence in this case) that prior to the compulsory use of such classified accounts the charges and credits to capital account were often made for the purpose of complying with some policy adopted by the owners, *without reference to the necessity of having the capital accounts reflect the cost of the property or the records show the actual investment* (R. 75).

The characteristic estimate of so-called "original cost," presented to the District Court by the Bemis's, father and son, does not purport to be the *actual* investment, even as shown by the books, from the beginning of the enterprise in 1870. It only purports to be the *opinion* of the witness as to what the investment *ought to be since 1881,* and disregards the construction history of the property from 1870 to 1881 and the large expenditures made on the property in those eleven years (R. 296; folios 348 and 349). It eliminates moneys actually shown to have been expended, ignores present market values of land, and gives no consideration to the failure to earn a fair return on the actual investment even during the period following 1881 (R. 146, 153, 316-317).

Several other figures were also submitted which only purported to be the opinion of the witness as to what an estimated original, historical or average replacement cost should or might have been. They are mere conclusions reached by taking *certain* figures from the books and *adjusting* them to conform to the ideas of the particular witness (R. 326, 337). The figure presented by one witness is the result of his "study" of the Commission engineer's ten-

year averages (R. 156). And this witness was followed by his father, who presented a figure which is the result of a "study" of his son's "study" (R. 163). Actual costs could not be obtained (R. 129).

Such testimony presents no determinative facts as to original cost or investment which can be definitely weighed, as could the facts which would be presented by the books and records of a company kept under regulatory supervision according to uniform classified accounts, designed to accurately show capital expenditures and investment.

The use made by appellants of the evidence as to so-called original costs, book costs and investment, is to show that the figures so produced are less than the valuation fixed by the Commission, and that therefore the Commission did not base its valuation on them alone. If such figures were dependable and were the *actual* original costs, book costs or investment, then the mathematical relation between them and the Commission's valuation would be thus established. But even if that were done, still, as has been so often and truly said, "the question would still have to be solved as to whether such" costs were "the same as the present value." Present value was the ultimate fact to be determined by the Commission and by the Court. Simply to show that the figure adopted by the Commission is a certain amount in excess of the original cost does not demonstrate that such figure is *present value,* nor does it demonstrate that in adopting such figure the Commission gave due consideration to present prices.

(C) Financial history, earnings, etc., of the appellee in earlier years.

Despite the irrelevancy of these matters to any present issue, we shall refer briefly to them, because the appellants predicate virtually their whole argument upon them.

No dividends were paid upon the $500,000 of capital stock of the Water Works Company of Indianapolis during its eleven years of operation, nor upon the $500,000 common stock of the Indianapolis Water Company until 1885 (R. 210). During the first fifteen years' operation of the Indianapolis Water Company, cash dividends declared amounted to only $55,000. During the next fourteen years, there was only one cash dividend, in the sum of $100,000. This total of $155,000 of cash dividends was the only money withdrawn from the property during forty years of operation, from 1870 to 1910, excepting the interest on certain bonds between 1890 and 1910 (R. 328; fol. 384).

The book value of the plant account in 1910 had grown to approximately $5,500,000, as a result of the reinvestment of earnings, and this figure, together with whatever appreciation attached to real estate values, was still represented by the original $500,000, aggregate par value, of common stock. In 1911, through a common stock dividend, the capital stock was increased from $500,000 to $5,000,000, but this of course did not and does not affect the amount of the useful property or its value.

Mr. Perk, in one of his exhibits (No. 56; R. 328), attempts to show an excess of earnings over a long period of time, by the application of net earnings *to the original $500,000 of par value of capital stock.* Mr. Hagenah in his exhibit (No. 4; R. 182; fol. 220) shows that as against an assumed rate of return of 7½ per cent. upon the actual investment, there was a substantial deficit in the property operations for a number of years.

From 1870 until 1913 (when State regulation began), the City, pursuant to contracts between it and the company, either affirmatively approved or assented to the rates that were charged. Therefore, during the entire history

of this enterprise, the moneys collected for the service rendered were lawfully collected and became the lawful property of the company. In *Newton* v. *Consolidated Gas Co.* (258 U. S. 165, at 175), this Court held that under such circumstances the presumption is that any profits from its business were lawfully acquired and that "mere past success could not support a demand that it continue to operate indefinitely at a loss." (See other cases cited on pages 78 and 79, *ante*.)

Notwithstanding this well-established rule of law, the appellants have made, in Mr. Perk's exhibit (No. 56; R. 328; fol. 384), a theoretical computation purporting to show that for the past forty-two and two-thirds years the company has earned 8.6 per cent. on all moneys invested and that such moneys include $644,749 from depreciation reserve and $3,423,471 from surplus earnings (Appellants' brief, pages 13, 29.)

The Perk exhibit (R. 328; fol. 384) is not in accord with the history of the property and is entirely misleading. In the first place, Mr. Perk deals only with the operations from 1881 and *ignores wholly the first eleven years of the property's operations.* The appellant Commission, in its Order No. 1400 (1917), itself recognized a plant account of the old company at $1,574,840 as of 1881 (R. 214). In 1881 the financial distress of the old Water Works Company led to a reorganization agreement among the bondholders and stockholders. To carry out this agreement the property was sold at judicial sale; the old common stock and the second and third mortgage bonds were wiped out, and a small amount of common stock in the present company was issued to cover the substantial losses of the original investors (R. 276). Upon the reorganization, the property and plant account was arbitrarily written down to $816,061.22, but none of the property and assets of the old company, total-

ing in excess of $1,500,000, was withdrawn from the operations. Mr. Perk, however, persistently refused to recognize the $750,000 of assets eliminated from the books in the reorganization set up but actually existing and remaining in the plant.

In the second place, for the more than fifty years of the property's history, Mr. Perk refuses to allow in his "rate base" anything for the market value, over and above the original cost, of the company's real estate. *This land was constantly appreciating in value.* In 1917, the appellant Commission itself found a land appreciation of not less than $1,500,000 (R. 215). On the hearing of this case before the District Court, it developed that the book cost of all land was $818,079 (R. 182). The present market value was shown to be at least $3,014,627 (R. 124, 261), showing an appreciation of about $2,200,000. Any reasonable allowance, year by year, for the actual, current value of the land alone would produce for those years a "rate base" which would entirely destroy Mr. Perk's conclusions as to the percentage earned.

In the third place, Mr. Perk's estimate of operating expenses during about forty years of operations (i. e., from 1870 to 1909) includes no allowance or provision for retirement expense or depreciation of the operating properties in those years. On the appellants' own theories, this allowance would have run into a substantial sum. As shown on page 87, *ante,* the appellants demand the deduction of no less than $1,878,705 from the present value of the property, as an additional amount which should have been collected for depreciation reserve *but was not.* Nevertheless, the appellants omit provision for it from their estimate of operating expenses.

If the foregoing obvious omissions be written into Mr.

Perk's exhibit, it entirely loses any effectiveness as an argument for appellants, on any theory that it shows more than reasonable earnings.

It should be added that the rate of dividends computed and used by appellants as a basis for their argument, is misleading. When analyzed it is found to have no significance as to the present *value* of the company's property. The dividend rate so used is simply the ratio of the earnings to the capital stock or the original cost of its plant, exclusive of appreciation in land and structural values. As pointed out on page 120, *ante*, the real significance of earnings can be comprehended only by ascertaining their ratio, not to the amount or par value of stock outstanding, but the *value* of the property used in producing the earnings *at the time* the earnings are produced. To ascertain whether the earnings of this enterprise were large or small in each of the years of its existence, it is necessary not only to know the amount of the earnings for each particular year, but also to know with equal precision the *value* of the property in that *same year*. Appellants have not attempted to present these necessary facts.

Nevertheless, Mr. Perk's misleading figures are used throughout the appellants' brief as virtually the sole basis for their argument that the appellee is not now entitled to an adequate return on the present value of its property.

(D) War-time "valuations" not reviewed by the appellee in the Courts.

Much of appellants' argument and the low valuation sought to be established by their computations are based upon prior orders of the Commission which were not litigated by the company. Their argument proceeds upon the theory that inasmuch as the company did not litigate those

former orders, it is now bound by them, and in this proceeding the present value of its property is limited to the valuation used in such former orders plus such additions and betterments as have been made since, regardless of whether those former orders reflected in fact the then present value.

There is no duty devolving upon a public utility to insist by litigation upon an adequate return upon the full present value of its property. The management of the property remains in the company as owner. If in its judgment it is for its best interests to accept *pro tempore* a rate which does not produce an adequate return on the present value of its property, it has a perfect right to follow such a course so long as, in its judgment, such course is for its best interests, and it can not be compelled to follow such course any longer than its judgment so dictates.

There was but one valuation study of this property (Order No. 1400; year 1917; *Re Indianapolis Water Co.*, P. U. R. 1917 E, page 556) by the Commission before Order No. 6613 (1923). The other alleged valuations referred to by appellants in their brief as "accepted" by the company were reached by adding extensions and betterments to the 1917 valuation.

Order No. 1400 and subsequent orders "accepted" by the company were handed down during the war period. Such "subsequent orders" were largely in the nature of emergency relief orders given during the war-time cost periods, then generally believed to be of an abnormal and temporary character.

At times there are conditions and circumstances which make it highly inadvisable to insist upon rates which produce a fair return on present value. A company should be commended, rather than penalized, for attempting to live under rates prescribed by a regulatory body, even if they

are less than the company could, by resort to litigation, show it was entitled to. This was particularly true of the war-time period of 1917, when individuals and corporations were compelled to make common sacrifices and to forego something of their full accustomed earnings, in order to further the economic solidarity of the Nation for the World War.

When, however, as in this case, *with each succeeding order the Commission cuts deeper below present value*, until, as shown on pages 111 to 116, *ante*, the Commission gives no weight or effect whatever to the increase in wages, prices and construction costs since 1917, there comes a time when in the exercise of its business judgment the company must resort to the courts. When it does so, the company is entitled to the independent judgment of the Court as to the present value of its property, without reference to what the Commission may have done in some prior proceeding that did not result in judicial review.

> "No estoppel from maintaining suit and securing relief in equity from the continuance of a constant, unconstitutional taking, day by day, of one's property without just compensation, arises from the fact that he has endured such a taking for a long time. The acquiescence of the victim of a wrongful continuing injury in its infliction in the past constitutes no defense against or estoppel of his right to an injunction against its future continuance."
>
> *City of Council Bluffs* v. *Omaha and C. B. St. Ry. Co.*, 9 Fed. (2nd) 246, 248 (Sanborn and Kenyon, *C.JJ.*, and Scott, *D.J.*); citing
>
> *Love* v. *Atchison, T. and S. F. Ry. Co.*, 185 Fed. 321, 322, 332; and
>
> *Menendez* v. *Holt*, 128 U. S. 514, 523, 524.

IX

WE RESPECTFULLY SUBMIT THAT THE DECREE OF THE DISTRICT COURT SHOULD BE AFFIRMED.

ALBERT BAKER,
JOSEPH J. DANIELS,
W. A. MCINERNY,
WILLIAM L. RANSOM,
Solicitors for Indianapolis Water Company.

APPENDIX

SALE BY THE STATE OF THE NORTHERN DIVISION OF THE CENTRAL CANAL

Two Statutes—January 19, 1850, and January 21, 1850

ACT APPROVED JANUARY 19, 1850

(General Laws of Indiana of 1850, pages 21-22)

Section 1. Be it enacted by the General Assembly of the State of Indiana, That the Governor of Indiana is hereby authorized and directed to effect a compromise of all controversies between the State of Indiana and the lessees of the water power of the Northern Division of the Central Canal. * * *

Sec. 2. In case the Governor shall fail to effect such compromise with the said lessees, or either of them, within three months from the passage of this act, he is then hereby authorized and directed to employ counsel and cause suits to be brought, etc. * * *

Sec. 3. The Governor is hereby further authorized to sell all the right, title, and interest of the State of Indiana, in and to the Northern Division of the Central Canal, and all the rents which shall become due after the sale of said property, and the water power and appurtenances thereunto belonging to the highest bidder therefor, on the terms and conditions and in the manner following: one-fourth of the purchase money to be paid down at the time of the sale, and the payment of the residue to be secured by approved security, and to be paid in equal annual installments thereafter. The purchaser or purchasers shall execute to the State of Indiana, and deliver to the Governor a bond with ample security conditioned to indemnify the State forever thereafter against all damages, claims or

demands, which the State may be subjected to or liable for, on account of any deficiency in the supply of water to such lessees, their heirs, or assigns. When the said one-fourth of the purchase money shall be paid and the residue thereof secured to be paid to the satisfaction of the Governor as above provided, and the said bond executed and delivered, the Governor of Indiana shall in the name and under the seal of the State, execute and deliver to the said purchaser or purchasers a deed for the bed for the Northern Division of the Central Canal, including its banks, margins, tow-paths, side-cuts, feeders, basins, right of way, dams, water power, structures, and all the appurtenances thereunto belonging.

Sec. 4. Such sale shall take place in the City of Indianapolis, and shall be made within ten months from the passage of this act, etc. * * *

Sec. 5. This Act to be in force from and after its passage.

ACT APPROVED JANUARY 21, 1850

(General Laws of Indiana of 1850, pages 22-23)

Section 1. Be it enacted by the General Assembly of the State of Indiana, That the Governor and Auditor of State be and the same are hereby authorized to make sale and dispose of all the right, title, interest, claim and demand which the State holds in or to the Northern Division of the Central Canal situated in State of Indiana with all the water power and appurtenances thereunto belonging, and the said Governor and Auditor are hereby authorized to convey the same to the purchaser on behalf of the State, in the name of the State of Indiana, all the right,

title, interest, claim, and demand, which the State may hold or possess in such canal; Provided, however, That neither the Governor nor Auditor of State shall be authorized to sell said canal for a less sum than two-thirds of the fair appraised value thereof: Provided, That the portion of the canal and appurtenances in the county of Morgan shall be appraised, offered, and made sale of, as a separate and distinct division of the said property.

Sec. 2. That the office of the Agent of the Northern Division of the Central Canal be and is hereby abolished.
* * *

Sec. 3. That the Governor and Auditor of State shall, before selling said canal, obtain a full and fair valuation thereof, under the appraisement and oath of not less than two resident freeholders of the county of Marion, one of whom shall be a qualified engineer; and payment may be made in the bonds of the State of Indiana at their market value at the date of sale thereof, or for cash down, as the Governor and Auditor may order and direct in the written terms of sale, of which terms and day of sale due notice shall be made in the *State Sentinel* and *State Journal* for not less than sixty days prior to the day of sale.

Sec. 4. This Act is to be in force from and after passage.

APPROVAL BY INDIANA LEGISLATURE OF SALE OF THE NORTHERN DIVISION OF THE CENTRAL CANAL

(General Laws of Indiana of 1851, page 200)

A Joint Resolution on the Subject of the Sale of the Northern Division of the Central Canal

Approved February 7, 1851

Resolved by the General Assembly of the State of Indiana, That the sales heretofore made by His Excellency the Governor, of the Northern Division of the Central Canal as reported by him in his annual message, be, and the same are hereby approved, and that His Excellency the Governor be directed to convey the several portions of said canal, with the rights, privileges and appurtenances thereto belonging as sold by him to the purchasers, their heirs or assigns so soon as said purchasers severally, their heirs or assigns, shall pay the purchase money by them severally bid, and execute the bonds pursuant to the conditions of sale, to the acceptance of His Excellency the Governor.

PERTINENT PARTS OF AN ACT TO INCORPORATE THE CENTRAL CANAL MANUFACTURING, HYDRAULIC AND WATER WORKS COMPANY

Approved February 13, 1851

(Local Laws of Indiana of 1851, pages 358-360)

Section 1. Be it enacted by the General Assembly of the State of Indiana, That Francis A. Conwell, Henry Van Bergess, William Burnet, Luther G. Bingham, David F. Worcester, and their associates, successors, and assigns, be,

and are hereby made a corporation; by the name of the Central Canal Manufacturing, Hydraulic and Water Works Company, with power to use and lease water power on or adjacent to the property belonging to said company for manufacturing purposes, and for the purposes of supplying the city of Indianapolis in the county of Marion and State of Indiana, with water for the use and convenience of said city and its inhabitants, and in that name may purchase, hold, and convey, any such property or estate, real or personal, as may be deemed necessary for the uses and purposes aforesaid; may sue and be sued, plead and be impleaded, contract and be contracted with, may make and use a common seal, and shall have such other powers as may be necessary to carry out the objects of this act.

Sec. 7. The said company shall have power to make contracts with individuals and corporations to supply such individuals and corporations with water; also with the city council of the city of Indianapolis for the supply of public cisterns, fire plugs, etc., on such terms and at such places, and enforce such contracts, and receive such compensation as may be agreed upon by the parties, for which said purposes said company shall have the right of constructing, relaying, or repairing any of the works contemplated by this act, to enter upon, use, or enjoy any lands, streets, roads, lanes or alleys, and to take materials therefrom for the purposes aforesaid, doing no unnecessary damages and making no unnecessary obstruction; but said corporation shall pay to individual proprietors of such lands a fair and reasonable compensation for the damage actually sustained by them. * * *

Sec. 9. Should said company, or any of the members thereof, or any other person or persons obtain an assign-

ment from George G. Shoup, James Rariden, and John S. Newman, or any of them, of their purchase of the Northern Division of the Central Canal north of Morgan county, then and in that case the Governor is hereby authorized and directed to make the conveyance of that part of said canal above named to such assignees or to any part of the original purchasers and the assignees of the other purchaser or purchasers in as full and ample a manner as he could or should do to said purchasers or assignees or part of such purchasers and assignees of the other purchaser or purchasers executing bond in the same penalty and with security to be approved by the Governor in the same manner as said purchasers are now required to do: It is further provided, That the lessees from the State upon said canal shall have the right to sue said assignees in any court of competent jurisdiction for any damages they may sustain from the neglect or failure of said assigns to furnish them water or do any other thing the State has agreed to do.

Sec. 10. And the property so conveyed to such assignees shall be forever held and bound for the faithful performance of the conditions of said bond for the benefit of the lessees and all other persons interested; and the Governor whenever he may from time to time think the security insufficient require additional security on said bond.

Sec. 11. This Act is to be in force from and after its passage.

Appendix

PERTINENT PARTS OF THE STATUTE UNDER WHICH THE APPELLEE'S PREDECESSOR—THE WATER WORKS COMPANY OF INDIANAPOLIS—WAS ORGANIZED

Approved March 6, 1865

(Session Laws of 1865, pages 103-104)

"Section 1. Be it enacted by the General Assembly of the State of Indiana, That whenever the City Council, of any incorporated City, in the State of Indiana, shall, by resolution, declare that it is expedient to have constructed works for the purpose of supplying such city and the inhabitants thereof with water, but that if it is inexpedient for such City, under the powers granted in its acts of incorporation, to build such works, it shall be lawful for the inhabitants of any such City, and others, to organize a company for the construction of such works."

"Section 7. Any such City may become a stockholder in any such company whenever the Common Council shall so direct. * * *"